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ABBREVIATIONS USED

AD.......................... JOINT-STOCK COMPANY
AEAF .... AGENCY FOR ECONOMIC ANALYSIS AND FORECASTS
AICB .... ASSCIATION OF INDUSTRIAL CPITAL IN BULGARIA
APOS..................... ACT ON PUBLIC OFFERING OF SECURITIES
AST........................ ACT ON THE STRUCTURE OF TERRITORY
BAS .... BULGARIAN ACADEMY OF SCIENCE
BASPIC .... BULGARIAN ASSOCIATION OF SUPPLEMENTARY PENSION INSURANCE COMPANIES
BCCI .... BULGARIAN CHAMBER OF COMMERCE AND INDUSTRY
BDU .... BULGARIAN DOCTORS' UNION
BNB .... BULGARIAN NATIONAL BANK
BNR....................... BULGARIAN NATIONAL RADIO
BNT .... BULGARIAN NATIONAL TELEVISION
BRS .... BULGARIAN RIVER SHIPING
BSE .... BULGARIAN STOCK EXCHANGE
BTC .... BULGARIAN TELECOMMUNICATIONS COMPANY
BVU .... BULGARIAN VIRTUAL UNIVERSITY
CEE .... CENTRAL AND EASTERN EUROPE
CHHP .... COMBINED HEAT AND POWER PLANT
CITA....................... CORPORATE INCOME TAX ACT
CoM .... COUNCIL OF MINISTERS
CPC....................... COMMISSION FOR PROTECTION OF COMPETITION
CRC....................... COMMUNICATIONS REGUATORY COMMISSION
DFI......................... DIRECT FOREIGN INVESTMENTS
EA.......................... EMPLOYMENT AGENCY
EAPSME................ EXECUTIVE AGENCY FOR PROMOTION OF SMALL AND MEDIUM-SIZED ENTERPRISES
EC.......................... EUROPEAN COMMISSION
EMEPA .... ENTERPRISE FOR MANAGEMENT OF ENVIRONMENTAL PROTECTION ACTIVITIES
EU.......................... EUROPEAN UNION
FR.......................... FISCAL RESERVE
FSC .... FINANCIAL SUPERVISION COMMISSION
FTP........................ FINAL AND TRANSITIONAL PROVISIONS
GDP....................... GROSS DOMESTIC PRODUCT
GMOs .... GENETICALLY MODIFIED ORGANISMS
GS .... GOVERNMENT SECURITIES
GVA .... GROSS VALUE ADDED
HIC .... HEALTH INSURANCE COMPANY
HIC .... HEALTH INSURANCE COMPANY
ICT......................... INFORMATION AND COMMUNICATIONS TECHNOLOGY
IMF .... INTERNATIONAL MONETARY FUND
IT .... INFORMATION TECHNOLOGIES
LE .... LEGAL ENTITY
LTCA...................... LOCAL TAXES AND CHARGES ACT
MAF .... MINISTRY OF AGRICULTURE AND FORESTRY
MEER .... MINISTRY OF ENERGY AND ENERGY RESOURCES
MES....................... MINISTRY OF EDUCATION AND SCIENCE
MEW...................... MINISTRY OF THE ENVIRONMENT AND WATER
MLSP..................... MINISTRY OF LABOR AND SOCIAL POLICY
MoE .... MINISTRY OF ECONOMY
MoF .... MINISTRY OF FINANCE
MoH .... MINISTRY OF HEALTH
MRDPW................. MINISTRY OF REGIONAL DEVELOPMENT AND PUBLIC WORKS
MRF .... MOVEMENT FOR RIGHTS AND FREEDOM
MRR .... MINIMUM RESERVE REQUIREMENTS
MTC....................... MINISTRY OF TRANSPORT AND COMMUNICATIONS

ABBREVIATIONS USED

MV .... MOTOR VEHICLE
NA.......................... NATIONAL ASSEMBLY
NAMRB.................. NATIONAL ASSOCIATION OF MUNICIPALITIES IN THE REPUBLIC OF BULGARIA
NEC .... NATIONAL ELECTRICITY COMPANY
NFA........................ NATIONAL FRAMEWORK AGREEMENT
NHIF .... NATIONAL HEALTH INSURANCE FUND
NMB....................... NAVIGATION MARITIME BULGARE
NMSII..................... NATIONAL MOVEMENT SIMEON THE SECOND
NPISH.................... NON-PROFIT INSTITUTIONS SERVICING HOUSEHOLDS
NPP .... NUCLEAR POWER PLANT
NRA .... NATIONAL REVENUE AGENCY
NSI......................... NATIONAL STATISTICS INSTITUTE
NSSI .... NATIONAL SOCIAL SECURITY INSTITUTE
PA .... PRIVATIZATION AGENCY
PIC......................... PENSION INSURANCE COMPANY
PIT .... PERSONAL INCOME TAX
PITA....................... PERSONAL INCOME TAX ACT
PPA........................ PUBLIC PROCUREMENT ACT
PPPCA................... PRIVATISATION AND POST-PRIVATISATION CONTROL ACT
R&D .... RESEARCH AND DEVELOPMENT
RB.......................... REPUBLICAN BUDGET
RDI .... REGIONAL DIRECTORATE OF THE INTERIOR
SEE .... SOUTH EASTERN EUROPE
SERC..................... STATE ENERGY REGULATORY COMMISSION
SHEI .... STATE HIGHER EDUCATION INSTITUTION
SME....................... SMALL AND MEDIUM SIZED ENTERPRISES
SMEA..................... SMALL AND MEDIUM-SIZED ENTERPRISES ACT
SP .... SOLE ROPRIETOR
SRI......................... SPECIAL RIGHTS OF ISSUE
SSI......................... STATE SOCIAL INSURANCE
TCA........................ TELECOMMUNICATIONS ACT
TPC .... TAX PROCEDURE CODE
UDB....................... UNION OF DENTISTS IN BULGARIA
UN .... UNITED NATIONS
UNDP .... UNITED NATIONS DEVELOPMENT PROGRAM
USAID.................... UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT
VAT .... VALUE ADDED TAX
VATA...................... VALUE ADDED TAX ACT
WTO .... WORLD TRADE ORGANIZATION

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SUMMARY

The stable economic growth continues in early 2005. Services, and particularly tourism, energize the economy. Tthe banking sector and the capital market grow stronger. The Bulgarian economy remains attractive for foreign investors. The trend in budget surpluses continues.

At the same time, a number of indicators confirm our projections that current factors of dynamic growth are close to exhaustion. Growth in business investment and household consumption has decelerated. The widening trade deficit gap is a cause for concern. Today, the low standard of living remains the central problem of the economy. The public discontent with healthcare continues. While enterprise policy registers a meaningful progress, much remains to be done.

The Bulgarian economy registered accelerated growth throughout the whole 2004. While total **economic growth** (GDP real growth of 5.6 per cent over 2003) registers peak values for the last five years, it is still insufficient to accelerate Bulgaria's economic progress and to achieve the target of approaching the European income levels. The Bulgarian economy has not yet reached 1989 levels, and 2004 real GDP stands at 92 per cent of the 1989 level.

The accelerated value added growth in services (6 per cent against 4 per cent in 2003) is the driving force behind **output GDP** in 2004, and registers once again higher growth relative to industrial production. Value added in agriculture is 2.2 per cent, up following a 1 per cent decline in 2003. Despite intensive real estate construction, value added in industry overall decelerates (5.3 per cent against 6.8 per cent in 2003). The overall dynamics of the value added in the private and the public sector results in 5.4 per cent total value added growth for the economy, which should hardly be regarded as reassuring. The reason lies in the rather slow decline of the value added in the public sector (0.6 per cent), which offsets the accelerated growth of 2 percentage points in the private sector (7.5 in 2004 against 6.5 in 2003). Growth in the private sector is not yet sufficient to achieve the desired acceleration of economic growth.

The accelerated growth in terms of **GDP consumption** relates to lower growth in domestic demand and higher growth for export goods and services. Deceleration in investment growth (12 per cent against 13.9 per cent in 2003) would hardly contribute to accelerated economic growth in coming years. Growth in final consumption is slowing down as well (5 per cent against 6.6 per cent in 2003), as a result of the slower growth in household consumption (4.8 per cent against 7.1 per cent in 2003). The higher GDP growth in 2004 is based on higher annual growth in foreign demand, i.e. the export of goods and services, by 13.1 per cent (5 percentage points up on 2003 growth). Imports are down to 14.1 per cent from 15.3 per cent in 2003. Due to the above dynamics, the foreign trade deficit registers slower growth compared to 2003.

The positive changes in the structure of the 2004 financing sources for **investments** are due to increased domestic savings, and in particular to current transfers from abroad. As a result, the savings rate in the economy is 16.1 per cent, up 4 per cent from 2003.

The **current account** deficit registers decrease (7.5 per cent of GDP against 9.3 per cent in 2003) despite the higher balance of trade deficit (14.0 per cent of GDP against 12.5 per cent in 2003). This improvement is a result of the positive change in all other items of the current account – services, current transfers and income. The positive balance in services and current transfers is up in 2004 versus 2003 while the negative balance in incomes registers decrease. This is basically due to the higher net positive balance from tourism. The net inflow of transfers from abroad, particularly private transfers, registers accelerated increase in the last four years.

Growth in **foreign trade** remains stable in early 2005. The major contributors are the solid (anticipated) 4 per cent growth of global economy, the sustained development of a number of export-oriented productions in Bulgaria, the strong demand and the expected sustained growth in the demand for metals in international markets. Unfavorable factors include the high and volatile crude oil prices, the rather weak European economy, and the insufficient flexibility of Bulgarian companies to changes in foreign markets (e.g., dropping of quotas for Chinese textiles). The nominal growth of exports and imports in Euro is almost equal (about 20 per cent in 2004 and 28 per cent in early 2005). The foreign trade balance deficit (exports FOB – imports CIF) is up, exceeding EUR 3.6 b in 2004. According to preliminary data, export volume stands around EUR 8B and import volume at EUR 11.6B. The increasingly higher growth in imports results from the increased share of imported components in the production of Bulgarian export goods, from the continuing investment activity in the country, from the higher consumer demand due to increased disposable incomes, from the lower unemployment rate, and from the expansion of bank credit.

According to preliminary data, **foreign investments** in 2004 amount to EUR 2.1 b. According to our estimates, however, upon the usual updates and revisions, foreign investments will exceed EUR 2.5 b (35 per cent up on 2003). The revisions generally affect data on investments "from scratch" and reinvested profit, because proceeds from privatization are known in advance and are immediately reflected in the reports, whereas companies report proceeds from investments with a lag of about a year. We expect the volume of foreign direct investments to remain at rather high levels in 2005 as well.

In 2004 the **consumer price** dynamics is rather fluent and is generally determined by the changes in administratively-determined prices. In 2004 the consumer price index is up 6.1% from 2003. In 2004 the producer prices index is up about 6 per cent from 2003. The accumulated year-end (December on December) increase of producer prices is 5.1 per cent, which is higher than the accumulated consumer price inflation (4.0 per cent).

The accelerated economic growth in 2004 is accompanied by higher **employment** and lower unemployment rates. The working population registers increase (38.9 thousand up on the 2003 average annual number) due to higher growth in employment (88.2 thousand up) compared to the decline in unemployment (49.3 thousand down).

Throughout 2004, employment growth is higher relative to **output** growth. This fact highlights the issue of restructuring labor into more productive activities as a way to accelerate growth.

The lower value of the Estat **business climate index** for January was generally a result of lower propensity to invest during the Winter season, which is typical for this time of the year. At the same time, the condition of companies seems solid, insofar as the ratio of the companies in good condition relative to those in poor condition remains stable, particularly in recent quarters. The prospering/sinking companies ratio remains extremely favorable. The positive trends in the condition of companies, registered throughout 2004, are unchanged in the winter months of 2005 as well. The low January 2005 value is basically a result of managers' prudence and restraint. The component registering the attitudes towards legislation, tax rates, government policy, and government regulation remains stable as well.

In early 2005, positive development is observed with respect to a number of **enterprise policy** issues that were the focus of attention throughout 2004 as well. The National Innovation Fund became operational. Its initial budget of BGN 5M for the first year of operation (though modest) is a good application of the Innovation Strategy (adopted in the summer of 2004). Bulgarian companies registered improvement in their access to finance. At the same time, the government is now encouraging not only foreign investments in Bulgaria, but also Bulgarian investments abroad by introducing foreign investment insurance. Bulgarian business is getting increasingly aware of European standards in certain sectors.

However, the delay of measures in areas important for improving competitiveness of the Bulgarian economy generates concern. The problems concern the delays in adopting alternative legal practices for reducing the circular (mutual) indebtedness of companies, in removing commercial registration out of the court system, and in implementing the Act on the Restriction of Administrative Regulation and Administrative Control on Economic Activity. The failure to privatize Bulgartabac and the introduction of non-competitive concession practices for Bulgarian infrastructure projects had a negative effect on economic development.

Other necessary measures were not implemented at all, such as passing the bill on the promotion of investments in SMEs and the bill on the promotion of innovations, which were mentioned in a couple of CED reports.

In the first months of 2005 **public finance** is characterized by very good implementation of the consolidated fiscal program, whose surplus at end of February stands at BGN 134 m. The surplus of revenues in the central budget continues, with VAT accounting for the highest relative share (about 50 per cent). The projections of delayed tax preferences are confirmed by the surplus in almost all tax revenue items. Current expenditures and expenditures on interest account for the highest relative share in expenditures. The different positions of the Government and IMF at the end of 2004 prevented an agreement on the direction of future fiscal policy. The minimal wage reached BGN 150 and a portion of the surplus went to finance the state-owned Public Investment Projects EAD. Due to the prepayment of Brady bonds to the amount of BGN 1.734 m, the debt/GDP ratio reached record low level of 34.4 per cent.

Unemployment steadily declined both in relative and in absolute terms. According to the labor force survey, the unemployment rate dropped to 12.0 per cent in 2004, and the average annual number of unemployed is estimated at 399.8 thousand people. Yet the average number of registered unemployed in the Employment Agency (about 469 thousand people) remains higher. At the same time, this unemployment rate registers notable decrease from the respective levels for 2004 and 2003. The number of newly-created jobs decreased after December 2004; if this trend persists, it will limit the opportunities to reduce unemployment.

The 2005 **National Employment Plan** targets an average annual unemployment of 12.5 per cent, with implementation of almost 100 special subsidized employment programs. Yet the prolonged implementation of such programs and on such a massive scale is not a solution to the problems of the labor market. All major social policy subjects (the State, the business, local authorities, non-government organizations) should continue to look for and experiment with flexible and innovative approaches for reducing unemployment and poverty, and focus on overcoming the education and qualification deficiency of the labor force.

The problem of low incomes and **standard of living** arouse public interest since the beginning of the year, with debates often revealing populist attitudes. The data from NSI's regular consumer survey (the latest conducted in January 2005) outline a slight upward trend in the pessimistic evaluations and attitudes. Till yearend consumers do not expect more notable negative trends in the development of the Bulgarian economic situation and in the consumer price dynamics. In January and February 2005. real incomes of households registered accelerated growth from the 2004 average quarterly levels. The consumer credit growth for 2004 is 74.8 per cent, an indirect sign of household income growth and of anticipation of stable future income growth.

While an increasing number of Bulgarian households have the opportunity to get consumer and housing loans, poverty is becoming a permanent fixture for some regions and municipalities. The distribution of municipalities by poverty level reveals that in 30 Bulgarian municipalities more than one fourth and in 13 municipalities more than one third of the population is poor. With a total of 264 municipalities in Bulgaria, this makes for about 16 per cent of poor municipalities. The latter host 5.1 per cent of all Bulgarians. Cririal to overcoming poverty and social exclusion in the so-called “poverty niches” is the program of the Ministry of Labor and Social Policy launched as a pilot project in the 13 Bulgarian municipalities with the highest poverty levels. Its objective is to provide the unemployed with literacy and professional qualification training and to provide subsidized employment and support for self-employment.

The high social security burden in Bulgaria remains a major reason for entrepreneurs to refrain from making social security contributions to NSSI on the basis of full wages and for the continuing high level of unregistered employment. The business regulations in this area, which were introduced two years ago, had some positive effect but did not prove very efficient in fighting the “grey economy”. That is why during the last six months the problem of the high social security burden was raised on the agenda by representatives of the employers, trade unions, and non-governmental organizations, as well as by representatives of different political parties. This indicates that political will is present for legislative initiatives along these lines. KNSB has made the most topical proposal for reforms. It includes differentiated rates of the compulsory personal social security contributions depending on the income, involving the State as a universal insurer along with the worker and the employer, making public servants pay for their personal social security contributions. In our opinion, the solution of the problem with the long-term financial sustainability of the pension system should involve the reduction of the social security burden and the setup of a reserve fund financed by domestic and foreign sources.

The Center for Economic Development regards 2004 as successful for the development of the Bulgarian **pension insurance** market. Accumulated pension fund assets amount to more than BGN 787 m, and according to the projections of the Bulgarian Association of Supplementary Pension Insurance Companies, they will amount to over BGN 4 b by 2010. With a view to appropriately use this huge pool of funds to improve the competitiveness of the Bulgarian economy, there is a need to have the capital market institutions propose, in cooperation with the employers’ organizations, new investment instruments that are more attractive for business and the institutional investors.

The buildup of serious public discontent with the operation of the **healthcare system** requires a timely national consensus on the development of the Bulgarian healthcare model. This is, however, hardly probable, given the coming parliamentary elections and the lack of political will for such consensus. In our opinion, the Bulgarian healthcare model should develop along the following lines:

- Achieving a public-private sector balance in healthcare, with the preponderance of the private sector;
- Implementing an integrated information system for monitoring and control of the sector;
- Encouraging the development of voluntary health insurance;
- Creating mechanisms for efficient competition in the healthcare sector and for efficient protection of patients’ rights;
- Eliminating the monopoly of NHIF;
- Continuing the reform in the hospital care sector;
- Improving the mechanism of negotiating the National Framework Agreements;
- Building adequate administrative capacity for overcoming the challenges arising from the forthcoming EU accession.

In the first quarter of 2005 the major focal points in **environmental policy** concern climatic changes, sustainable management of natural resources and biodiversity preservation. In connection with the enforcement of the Kyoto Protocol, Bulgaria announced 250 m tons of saved free emissions against the basic quantities negotiated in 1990. This is Bulgaria’s potential for involvement in the international trade in emissions. The Act on the Genetically Modified Organisms (GMO) passed and promulgated in March 2005 introduces strict requirements for Bulgarian companies whose scope of business involves disposal in the environment, trade in or use of GMO. The regulator, the Ministry of Agriculture and Forestry, is obligated to maintain an electronic Register of Issued Licenses for GMO Marketing and to guarantee public access to information about the companies in the register.

The use of natural resources is a subject-matter of two new bills developed by the Council of Ministers and introduced in the National Assembly – the Act on Water Management and the Caves Act. Another two draft laws – Amendments to the Biodiversity Act and Amendments to the Protected Territories Act, were subjected to severe criticism by civil and environmental associations for containing regulations that create prerequisites for disturbing the biodiversity and integrity of Bulgarian national parks and protected territories.

The banking system still dominates the financial sector and financial intermediation. The aggressive credit expansion persists. The new regulation of BNB targeting lower lending growth did not yield the desired result; on the contrary, it lead to record-breaking credit growth in March. The reason is that this measure has not been carefully designed and has proved ineffective. Banks can evade it by artificially inflating their credit portfolios prior to the enforcement of the regulation, by redirecting their lending to their leasing companies, and by additional lending from abroad. Major weaknesses of the regulation include lack of discrimination between bank size, type of loan, maturity, collateral, and currency.

The capital market registers higher contribution in total financial intermediation, which however remains modest compared to that of the banking sector. Due to the fact that shares in BTC were accepted for trading on the stock exchange, BTC’s market cap registered notable growth in a couple of months. The sale of BTC on the stock exchange will be remembered as a key event in the modern history of Bulgarian capital markets. The auction for the shares in BTC was completed without problems and represents the best proof so far of the efficiency of stock exchange systems in placing orders and trading, as well as of the potential of the Bulgarian capital market to undertake large privatization transactions. It should be noted, however, that the average traded free volume of companies on BSE–Sofia accounts for no more than 1/4 – 1/3 of average capitalization. While liquidity is up, it nonetheless remains low. Capitalization registers sizeable growth in the last 12 months. BSE – Sofia started to calculate a new “extended” index, the so-called BG-40. The share price dynamics, particularly of liquid positions, increasingly reflects corporate events, which is a sign of improved investment culture of market participants and of higher market efficiency on the whole. The timely submission of reports by the majority of companies has become a practice.

Having adopted the fundamental legislative framework in **the transport sector,** attention focused on the attraction of private capital. The port terminals Somovit, Lesport and the hazardous cargo terminal in port Varna–West were offered for concession. Somovit Port enjoys so far serious interest, with ten companies bidding for it. In competition with another three international consortiums, Copenhagen Airports A/S was declared the successful bidder for the airports in Varna and Burgas. The controversial concession of Trakia Highway stands out from these positive events. In this case, the market principles prescribing a competition procedure for appointment of a concessionaire have been neglected.

Government efforts to establish a functional domestic and regional **energy market** continue. At this stage, Bulgaria does not have yet an established electricity market; in this respect the country does not differ much from the other countries of South-East Europe. At the same time, Bulgaria still lags in this respect far behind the EU, despite having another two years to completely liberalize this market. So far, market liberalization in Bulgaria stands at 22 per cent against 11.6 per cent for South-East Europe and 73 per cent for the EU (25). While oil prices preserved their upward trend, national natural gas prices, which are subject to administrative regulation, have been reduced since early March.

Data about the number of foreign tourists and tourism revenues in 2004 confirm the positive trend in **tourism**. In the past year, revenues from international tourism amounted to EUR 1 746.3 m, up 20.77 m from 2003. The positive net revenue from tourism amounts to more than EUR 970 m, up 21 per cent from 2003. Tourism preserves its dynamic development in the beginning of 2005 – January 2005 revenues are up 20.5 per cent from January 2004 and amount to more than EUR 77 m.

Analysis of the tourism sector reveals that the process of expanding and modernizing the its infrastructure continues. At the same time, some of the most serious problems in tourism resurface again in the first months of 2005 – chaotic construction in major resorts, lack of infrastructure capacity in some areas, particularly roads and other general infrastructure, to satisfy the increasing demand in the sector. The problem of preserving the environmental balance is aggravating. As a result of these negative processes, the preliminary data of tour operators on holiday bookings give grounds to expect an outflow of tourists, particularly German, from major sea resorts. The emerging shortage of qualified labor is a major threat to future competitiveness of the sector.

Due to the favorable weather conditions in 2004, a significant portion of **agricultural production** registered notable growth on 2003. While the sustainable development of agriculture continues, the share of the sector in GDP and GVA preserves its downward trend, accounting respectively for 9.5 and 11 per cent on an annual basis for 2004. The funds from SAPARD and SF Agriculture contribute to the good performance of the sector. Increased production generates higher export potential – in 2004 total export of processed and unprocessed agricultural goods is over EUR 730 m. Import is estimated at EUR 575 m, whereby the positive agricultural trade balance is preserved.

The coming years before the EU accession are crucial for Bulgaria’s preparation to implement an efficient **regional policy**. Efforts intensify to implement strategic planning, to improve project development capacity, to delegate higher autonomy to local authorities in economic development, and to implement good practices in local self-government. The preparation of the National Development Plan 2007-2013, with its 6 operational programs that outline the basic guidelines for utilization of European funds, continued in the first months of 2005. The six programs cover the following areas: Bulgarian competitiveness, human resources, agricultural and rural regions, environment protection, transport infrastructure, and regional development. Six working groups involving experts from different ministries and representatives of non-governmental organizations developed the analytics of the operational programs – the social and economic analysis and the SWOT analysis.

Special attention is devoted to the preparation of the regional development and structural strategies and schemes at NUTS III level and of the municipal development plans at NUTS IV level. The preparation of the regional development plans at NUTS II level is clearly more difficult.

Cluster formation is an efficient mechanism for regional development, for economic growth, and for balanced growth between various regions. In Bulgaria, the networked interconnection, especially between small and medium-sized enterprises, into related cluster production became very popular in the second half of 2004 and the early 2005. The leading incentives for cooperation include: a strive for better solutions of common problems, facilitation of market and business strategies, better distribution and logistics, better opportunities to innovate. Various Bulgarian sectors and regions have formed clusters. This process has been financially supported by the PHARE Program.

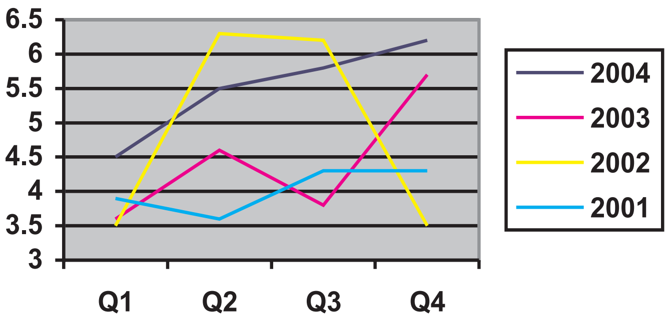
While positive developments are registered in the area of regional policy, there is a need for further efforts with respect to strategic planning, training for local administrations and improving their qualifications, development of public/private partnerships, and accelerating the fiscal decentralization in Bulgaria.

Gross Domestic Product

Economic growth. Throughout 2004 the Bulgarian economy was growing at accelerated pace. This is evident from NSI data published on 31 March 2005.[1] The initial estimate of overall economic growth based on national accounts for 2004 is 5.6 per cent real growth rate in GDP, up 1.1 percentage points on the revised growth rate estimate for 2003 (4.5 per cent). The year 2004 saw an upward economic dynamics, exceeding both government estimates and expectations of most analysts. However, acceleration could be assumed as insufficient in view of the need for Bulgaria to catch up with European income levels. Moreover, the highest annual GDP growth in 2004 is still below the 1989 level (92 per cent in real terms).

The fourth quarter marked the fastest growth compared with the other quarters in the past several years.

Figure 1. GDP, growth on corresponding quarter of previous year,%

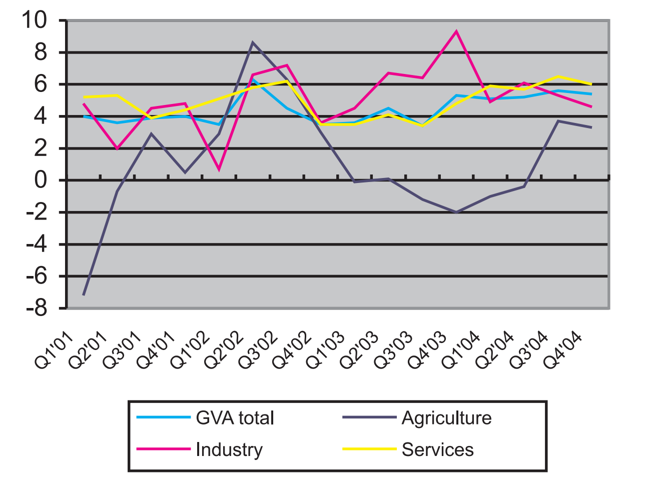


Source: NSI

Supply. In 2004 value added in the economy as a whole grew faster than in the previous year (by 5.4 per cent in 2004, from 4.2 per cent in 2003). Thus in combination with the faster growth in the item "Adjustments"[2] (by 7 per cent), the dynamics of the two main GDP aggregates on the production side contributed to its 5.6 per cent growth.

Growth by economic sector. The driver behind gross domestic product dynamics is accelerated value added growth in the services sector. The other two basic economic sectors also posted growth: agriculture and industry. In contrast to the previous year, in 2004 agriculture exhibited better results (a growth rate of 2.2 per cent on an annual basis, from 1 per cent decline in 2003). Special attention need be paid to industrial sector dynamics, however, because growth in industry as a whole slowed down (to 5.3 per cent from 6.8 per cent in 2003), despite robust construction. The services sector developed fastest, accelerating its growth rate (at 6 per cent from 4 per cent in 2003), again exceeding industry.

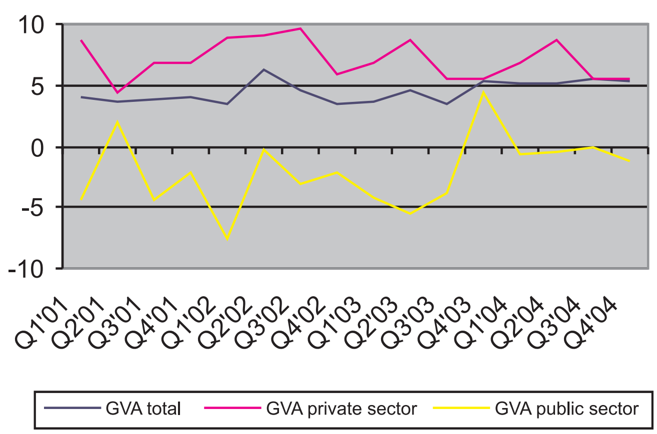
Figure 2. Value added by economic sector, growth on corresponding quarter of previous year, %



Source: NSI

Growth by type of ownership. The two main types of ownership (private and public) in the economy have an ever more divergent contribution to economic growth. Accelerated value added growth in overall economy is formed by accelerated growth in the private sector (7.5 per cent in 2004, from 6.5 per cent in 2003) and a slight fall in public sector value added (to a level of 0.6 per cent alone below the 2003 level, following an annual decline of over 2 per cent in the period 2001-2003). The overall result of value added dynamics in the private and public sectors could not be considered as reassuring since the relatively slight decline in the public sector actually neutralizes 2 percentage points of private sector growth, which in turn is not high enough to achieve the desired accelerated overall economic growth.

Figure 3.Value added growth in private sector and public sector on corresponding quarter of previous year, %



Source: NSI

1 Source: NSI, data from national accounts published on 31 March 2005: revised GDP data for 2003 and for the first, second, and third quarters of 2004, preliminary data for the fourth quarter of 2004 and for 2004 as a whole. NSI specify that :"available annual data about economic sectors as well as revision of annual GDP estimates for 2003 based on comprehensive accounting and statistical information entailed revision and adjustment of the quarterly GDP estimates for 2004". By way of comparison in brackets we show previous NSI estimates.

GDP growth, corresponding period of previous year =100, %					
	I Q.	II Q	III Q	IV Q	2004
2004	(5.3) 4.5	(6.0) 5.5	(5.8) 5.8	6.2	5.6
2003	(3.5) 3.6	(4.2) 4.6	(4.4) 3.8	(4.9) 5.7	(4.3) 4.5

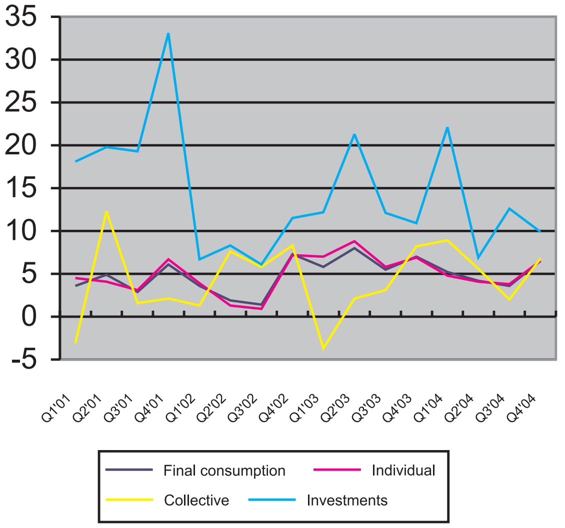
2 In calculating GDP under the production method the following methodological relationship is applied:
Gross domestic product (market prices) = Gross value added (base prices) + Adjustments, and Adjustments = Net taxes (excises, customs duties, VAT, less subsidies) on products less Financial Intermediaries' Services Indirectly Measured (FISIM). Source: NSI

Demand. Overall economic growth acceleration in terms of GDP use is characterized by slower growth in domestic demand and faster growth in export of goods and services. In the past 2004 investments grew faster than consumption. Final consumption dynamics follows closely the dynamics of individual consumption. Of note is the fact that collective consumption continued growing fastest, whose share by quarters against the annual volume is typically highest in the fourth quarter.

Investments[3]. If the trend of slowdown in investments sustains, a more dramatic acceleration in economic growth could hardly be expected in the next few years. The annual growth in investments slowed down in 2004 to 12 per cent, from 13.9 per cent in 2003. Nevertheless, the share of investments managed to exceed 20 per cent of GDP.

Consumption. Final consumption growth slowed down in 2004 to 5 per cent (from 6.6 per cent in the previous year) due to slower growth in individual consumption, 4.8 (from 7.1 per cent in 2003) against almost double growth in collective consumption, 5.8 per cent (from 3.0 per cent in 2003).

Figure 4. Consumption and investments, growth on corresponding quarter of previous year,%



Source: NSI

Export/import of goods and services. Against the backdrop of lower domestic demand in 2004, higher GDP growth was underpinned by higher annual external demand, i.e.export of goods and services.

At the end of 2003 growth in export of goods and services started accelerating. For 2004 as a whole exports grew by 13.1 per cent (by 5 percentage points faster than growth in the previous year) and import growth fell to 14.1 per cent (from 15.3 per cent in 2003). The result from divergent developments in export and import growth shows that worsening of the foreign trade balance on goods and services is more moderate than in the previous year. In 2004 the foreign trade deficit on goods and services increased by 10.3 per cent of GDP, 0.9 percentage points less favorable than in 2003. In 2003 the foreign trade deficit of goods and services was 9.4 per cent of GDP and the worsening on 2002 had been much more severe – by 2.8 percentage points (-6.6 per cent of GDP).

Figure 5. Exports and imports, growth on corresponding quarter of previous year,%

Source: NSI

Investment financing. Positive developments emerged within the structure of sources of investment financing in 2004 compared with the past three years. The importance of domestic savings, especially current transfers from abroad, increased. The rate of saving in the economy (share of gross national savings to GDP) reached 16.1 per cent and improved by some 4 per cent compared with 2003 year.

Table 1. Gross capital formation financing

	Financing, total	Gross national saving, total	Gross domestic saving	Current transfers from abroad, net	Income from abroad, net	External saving
In % of GDP						
2004	23.5	16.1	13.3	4.6	-1.8	7.4
2003	21.7	12.5	12.3	3.5	-3.2	9.2
2002	19.8	14.9	13.2	3.4	-1.7	4.9
2001	20.7	14.6	13.1	3.7	-2.2	6.1
Total financing =100, %						
2004	100	68.3	56.4	19.4	-7.5	31.7
2003	100	57.5	56.3	16.0	-14.8	42.5
2002	100	75.2	66.6	17.3	-8.7	24.8
2001	100	70.4	63.4	17.9	-10.8	29.6

Source: BNB, Balance of Payments, published at 31 March 2005; NSI, GDP, published at 31 March 2005, and own calculations

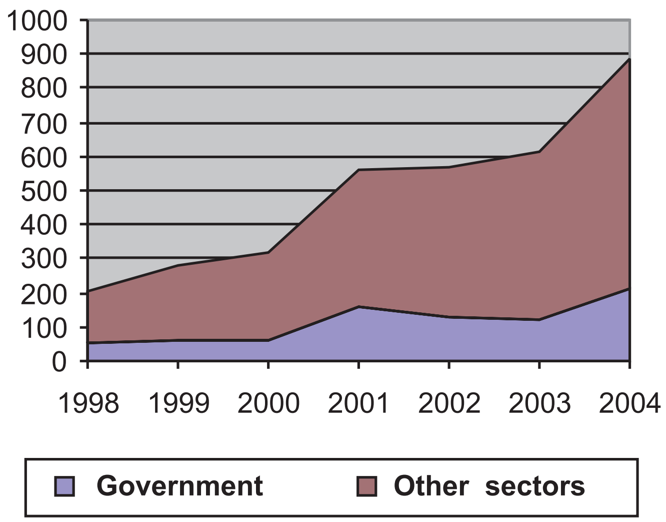
[3] Here for brevity we use Investments instead of Gross capital formation, which comprises costs for acquisition of tangible and intangible non-financial assets, including increase of work-in-progress. Source: NSI

Current account

The current account deficit improved despite the worsening in the trade deficit. The Balance of Payments current account deficit fell to 7.5 per cent of GDP, from 9.3 per cent in 2003. The deficit on foreign trade in goods deteriorated to 14.0 per cent of GDP from 12.5 per cent in 2003. The lower current account deficit is due to positive changes in all other items of the Balance of Payments current account – services, current transfers and income. Compared with 2003, in 2004 the surplus in services and current transfers increased and the deficit on income decreased.

Within the structure of the three groups of services in the Balance of Payments, improvement of the overall balance on services is due entirely to an increase in the surplus on travel (tourism) and a reversal of the deficit into surplus on item other services; and these changes made up for the worsening in the balance on transport services. Over the past four years net income from transfers from abroad grew fast and of note is the dynamics of private transfers, corresponding to item other sectors in the figure below.

Figure 6. Current transfers, net, m



Source: BNB, Balance of Payments, data published at 31 March 2005.

Foreign Trade

In early 2005 growth in foreign trade in goods stood stable. The following factors had a positive impact: (1) expected 4 per cent growth in global economy, (2) stable development of some export-oriented industries in the country, (3) favorable economic conditions, and (4) expected sustainable growth in demand for metals on the international markets. Unfavorable factors are: (1) high (and to some extent unpredictable) prices of crude oil, (2) comparatively low economic activity in EU member states and (3) low adaptability of Bulgarian companies to changes on international markets (e.g. removing the quotas for Chinese textile products).

In 2004 and early 2005 foreign trade dynamics shows that the national economy managed to cope with the adverse effects of high oil prices and the cheap US dollar. The higher volume of crude oil imports is offset by higher export of oil products. Strong orientation towards trade with European countries restricts the effect of the cheap dollar. Exports and imports in euro grew nominally at an almost equal pace (about 20 per cent in 2004 and 28 per cent in the beginning of 2005). The foreign trade balance deficit increased (exports FOB – imports CIF), exceeding EUR 3.6 b in 2004; according to preliminary data, exports amounted to almost EUR 8 b and imports totalled EUR 11.6 b. Ongoing increase in imports is accounted for by: (1) high import volume of Bulgarian exports, (2) ongoing investment activity in the country, (3) higher consumer demand as a result of higher net incomes, (4) lower unemployment and (5) development of bank lending.

Commodity structure of exports. The trend of increased share of commodities continued, metals and chemicals accounting for more than half of the increase. Given the emerging deficit in raw materials on the international markets (in the conditions of relatively slowly recovering global economy) and the cheap US dollar, expectations are that Bulgarian exporters would preserve their market positions and would increase the value of their exports. The relatively small growth in export of consumer goods (mainly clothing, footwear, foodstuffs, furniture) causes concern – their share dropped below 1/3 of total exports. This is due to the stagnation on the European market, being the main consumer of these goods.

Commodity structure of imports. The following trends emerged within the commodity structure of imports: (1) the volume and share of investment commodities increased (already 26.5 per cent), (2) the share of imported energy resources declined (from 17.6 to 16.7 per cent in 2004) despite their increased value, (3) the share of raw materials stood at the same level (about 40 per cent), (4) import of consumer goods grew fastest (by 28.4 per cent against 20.9 per cent for total imports). Three commodity groups with almost identical volumes (automobiles, medicine and cosmetics, and furniture and household appliances) accounted for over 60 per cent of imported consumer goods. This suggests increased paying capacity and demand of the public for items which do not belong to the so-called convenience goods and which are not produced by the national economy.

The geographic structure of trade shows some major changes. EU-25 remained Bulgaria's main trading partner with some 58 per cent in exports and 54 per cent in imports. Soon this market will no longer be external for the country and export and import dynamics in the future will depend on the development of trade with other partners. Balkan countries appear to be perspective markets and exports to these countries increased in 2004 by approximately 32 per cent and already exceed 20 per cent of total exports. Imports from these countries (mainly raw materials for the processing industry) also grew fast and reached about 10 per cent of total imports. Similar dynamics emerged with Asian countries, accounting for 6 per cent of exports and 9.7 per cent in imports. All this reflected on the ranking of the main partner countries – no suprises at the top of the list where EU Member States stand typically, but Romania and Serbia and Montenegro rank eighth and ninth in terms of exports and China and Romania in terms of imports. Turkey could be added to them, ranking third in exports and fourth in imports.

Foreign direct investments

A year ago CED forecast a **volume of foreign investments** for 2003 of about USD 2 b. Today this forecast is a fact. Following the latest revision of data on the inflow of foreign direct investments in Bulgaria the BNB calculated their volume at USD 2.1 b (EUR 1.85 b). This marks some 90 per cent growth on 2002, with green-field investments increasing two-fold and reinvested profit 2.5-fold. According to preliminary data, invested foreign capital in 2004 amounts to EUR 2.1 b. Our estimate following the usual data revision is that the volume of investments will exceed EUR 2.5 b (up 35 per cent on 2003). The revision will influence mainly data on green-field investments and reinvested profit because revenues from privatization are clear from the beginning while companies report investment inflow with a lag of one year. We expect that green-field investments and reinvested profit in 2004 would be twice as higher as those in 2003.

We expect the volume of foreign direct investments to sustain at a comparatively high level in 2005. Such assessment is based on data about the development of the global economy, ongoing processes of transferring entire productions from Western to Eastern Europe (including Bulgaria) for the purpose of optimizing costs and planned investment projects. Probably funds from privatization would not reach the 2004 level, but improved business climate, comparatively low prices of real estate and means of production and still vacant niches on the services market will boost attraction of new investments.

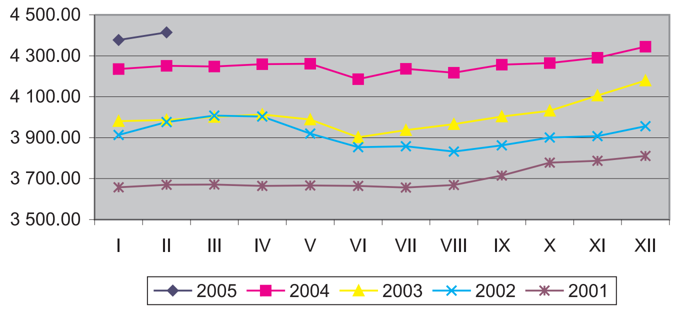
Inflation

Consumer prices. Inflation rate dynamics in 2004 was comparatively smooth, mainly consistent with changes in administrative prices. Average annual consumer prices for 2004 increased by 6.1 per cent above the average level in 2003.

In the first two months of current year the monthly inflation rate was less than 1 per cent. The most significant contribution for the monthly increase in consumer prices in January 2005 (by 0.7 per cent) had the seasonal price increase in vegetables. Monthly inflation rate in February was 0.9 per cent and according to AEAF higher than expected price increases occurred in seasonal fresh foodstuffs, fuels (influenced by international prices of crude oil and the US dollar exchange rate), some health services linked with the minimum wage level and higher prices of cigarettes. Estimates of AEAF show that increases in administrative prices contribute 0.1 percentage point to January inflation rate and 0.24 percentage points in overall February inflation rate[4].

Changes in consumer prices in the first two months of 2005 on corresponding months of 2004 accounted for 3.3 and 3.8 per cent. If the curve of change in 2005 is similar to the past year's dynamics, we could expect that average annual inflation rate will stay at over 3 per cent.

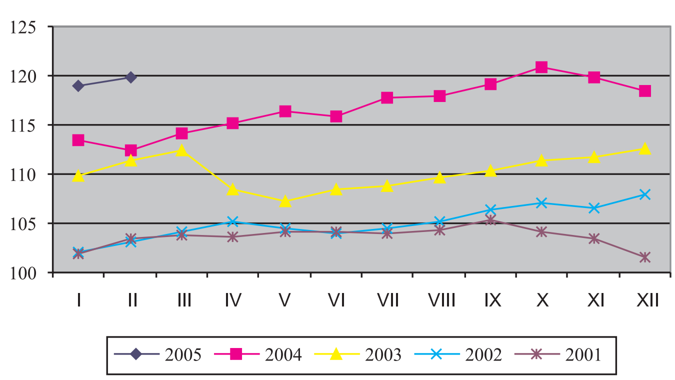
Figure 7. Consumer Price Index, 1995=100,%



Source: NSI

Producer prices. Average annual industrial producer prices on the domestic market for 2004 are about 6 per cent higher than the average level for 2003. The cumulative increase at the end of the year (December on December) by 5.1 per cent exceeds cumulative consumer price inflation (4.0 per cent).

Figure 8. Index of industrial producer prices on domestic market, 2000=100 (%)



Source: NSI

The January increase in producer prices by 0.44 per cent is due entirely to higher prices of energy goods, which also contributed to the overall monthly increase in producer prices

[4] Source: AEAF

[5] Source: AEAF

in February (by 0.76 per cent), though with a smaller share of 0.58 percentage points[5].

Data about higher industrial producer prices in the first two months of 2005 confirm the expectations of industrial entrepreneurs of a slight increase in selling prices, stated in NSI business surveys.

In March NSI business surveys register expectations of a slight increase in selling prices in industry, construction, retail trade and services in the next three months, i.e. in the second quarter of 2005.

Table 2. Managers' expectations in January, February and March 2005 about selling prices in the next three months

	January 2005	February 2005	March 2005
Industry	Expectations about slight increase	No expectations about increase	Expectations about slight increase
Construction	No expectations about increase	Expectations about increase	Sustained expectations about increase
Retail trade	No expectations about increase	Expectations about increase	Sustained expectations about increase
Services (without retail trade)	No expectations about increase	No expectations about increase	Expectations about increase

Source: NSI

Employment, productivity and unemployment

Accelerated economic growth in 2004 is associated with higher employment and lower unemployment.

Employment. Economic activity increased as a result of higher employment growth than unemployment decline. According to NSI data from labor force survey (LFS) the number of economically active persons in 2004 is 3,322.0 thousand persons aged over 15. The increased number of economically active persons[6] (by over 38.9 thousand against the average annual number in 2003) reflects an increase in the number of employed persons (by 88.2 thousand) and a decrease in the number of unemployed persons (by 49.3 thousand).

Productivity. Available quarterly data on the number of employed persons in 2003-2004 based on the labor force survey makes it possible to assess the growth in labor productivity measured as gross value added per one employed person and to compare the dynamics of productivity and employment in 2004 against corresponding quarters of 2003.

Table 3. GVA, number of employed persons and GVA per one employed person, total for economy – growth on corresponding period of 2003 (%)

	Q1'2004	Q2'2004	Q3'2004	Q4'2004
Gross value added	5.1	5.2	5.6	5.4
Employed persons	2.96	3.27	3.14	3.04
Gross value added per one employed person	2.08	1.87	2.39	2.29

Source: NSI and own calculations

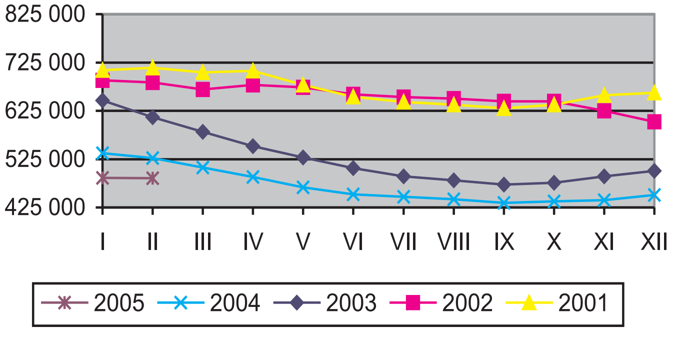
Employment grows faster than productivity, suggesting that new employment is not highly productive. Acceleration of overall economic growth would boost employment restructuring towards highly productive activities.

Unemployment. Unemployment exhibited a steady decline both in absolute number and as a ratio. The unemployment rate based on the labor force survey methodology fell from 13.7 per cent of the labor force in 2003 to 12.0 per cent in 2004. Youth unemployment (share of unemployed youths aged above 24 to the number of economically active youths in the same age group) declined from 28.2 per cent to 25.8 per cent. Within the structure of unemployment, the share of long-time unemployed persons (over one year) declined by 6 percentage points on the previous year and stood at 59.3 per cent.

The sample survey of labor force estimates the average annual number of unemployed persons in 2004 at 399.8 thousand. The average number of unemployed persons registered with the Employment Agency in 2004 is still high – about 469 thousand. Traditionally lower unemployment figures based on NSI data compared with EA data are due mainly to concealed employment.

According to Employment Agency data, the dynamics of registered unemployment is downward both in 2004 and the first two months of 2005.

Figure 9. Registered unemployed, number



Source: EA

Business Climate in Early 2005 [7]

Total business climate indicator. In the first quarter of 2005, the Total Business Climate indicator reached a distinctly higher

[6] Economically active population comprises persons above the age of 15 who furnish their labor (employed persons) or supply their labor (unemployed persons) for the production of goods and services.

[7] Source: Monthly NSI business surveys, publicly available data; The AEAF, based on NSI business survey figures that are more detailed than those publicly available.

level as compared to both the preceding quarter and the corresponding period of last year. Changes in the indicator (by (+) 5.0 points in January as compared to the preceding month, by (-) 2.2 points in February and by (+) 1.3 in March) were registered for all activities monitored through the NSI business surveys - Industry, Construction, Retail Trade, and Services Sector.

The composite "Business Climate Indicator in Industry" rose in January (by 1.8 points), went down considerably in February (by 3.3 points) and registered a slight increase in March (by 0.8 points).

The production assurance with orders (measured in months) rose to 5.6 in early 2005 as compared to 4.8 in October 2004. The average capacity utilization in industry rose by nearly 1 percentage point and is now estimated at 63.7 per cent - its highest value registered since 2000. However, the competitive position of enterprises both on the domestic and international market has not improved.

Business Climate in Industry. Industrial managers' positive expectations for the business condition of enterprises in the course of the next six months registered in January and March are the driving force behind the further increase in the values of the composite Business Climate in Industry indicator during the first quarter of the year. In January and February, a higher level of optimism was registered in respect to production activity over the next three months. The current production level in industry for January is assessed as higher when compared to the previous month, but lower for February and also for March (due to managers' opinion shift from "increase" to "keeping the same level" of production). Managers' evaluation on the current level of foreign demand went down in January, but again improved in February. Conversely, domestic demand registered an increase in January and decrease in February.

The trend for ever-closer ratings given to the "current situation" and "expectations for the next six months" deserves some attention. According to AEAF, one possible interpretation of this trend is that the production potential of industry has been reached and therefore lower growth rates are to be expected. Another indication for a possible slowing-down of industrial production growth are the increased stocks of finished goods registered in the March Industry survey, which (for the first time since the spring of 2002) shows a higher share of entrepreneurs reporting increased stocks as compared to those reporting a decrease.

Business Climate in Construction. The composite indicator Business Climate in Construction registered a higher upward movement in January as compared to the Industry indicator, and its (+) 16.0point increase is entirely due to the higher expectations for the business condition of construction enterprises in the course of the next six months. In February it went down slightly (by 1.6 points), again because of the lower ratings given to the current business situation in enterprises and in March was once more restored to its January levels. It thus remained 35 points above its long-term level throughout the three winter months.

The assessments about the production assurance with orders in construction (in "number of months") has improved from 6.1 in October to 9.4 in January, with enterprises expecting an influx of new orders in the course of the next six months. Surveys have registered a downward trend in the number of clients with delayed payments. The fact that the "insufficient demand" factor has registered its lowest level for the past ten years could be interpreted to indicate that the potential for accelerated growth in construction has not yet been depleted.

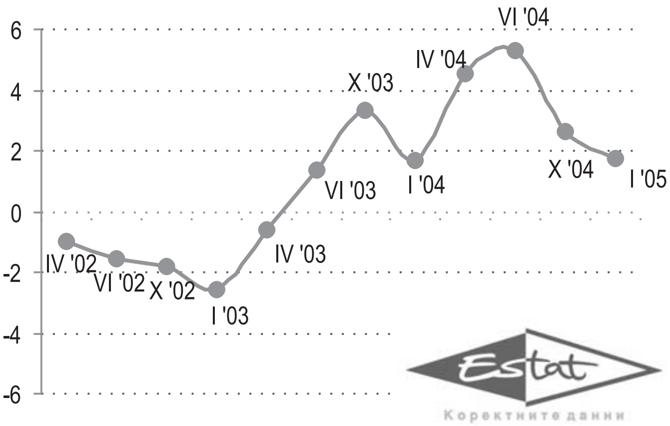
Business Climate in Retail Trade. The composite indicator Business Climate in Retail Trade for the first three months of the year is more than 10 points below its long-term average value. In January it rose by 2.0 points (due to the increased optimism for the business condition of enterprises), in February it went down 0.9 points (due to an opinion shift on the current business condition of enterprises from "good" to "satisfactory or normal for the season"), and it remained unchanged in March. "Insufficient demand" and "competition" continue to be the greatest impediments for business development, while the economic environment is seen as less insecure. It is worth noting the link between insufficient demand that is outlined as a major problem in retail trade also in the first quarter of 2005 and the growth-rate slowdown for individual consumption in 2004, which may serve as grounds to expect that the slowdown will be felt in early 2005.

Business Climate in Services (Retail Trade excluded). The composite indicator Business Climate in the Services Sector (retail trade excluded) rose in January by 3.1 points (due to the better ratings on the current and expected business situation in enterprises), in February it went down 1.9 points (entirely due to lower ratings on the current business situation in enterprises), and it rose again in March - by 3.2 points (due to the improved business condition and expectations for the next six months). Following the less favorable assessment on the current services demand in February as compared to January, demand in the services sector improved in March. Expectations for demand in services are positive. Unlike industry, in 2003 the services sector saw sustained higher ratings measuring the expectations for the next six months as compared to ratings measuring the current situation at the time of the survey. In our opinion, this conforms to the increased growth rate for value added in services in the course of 2004 and it could be interpreted as grounds to expect that growth in the services sector will continue in the months to come.

The Estat index of business climate[8]
January 2005

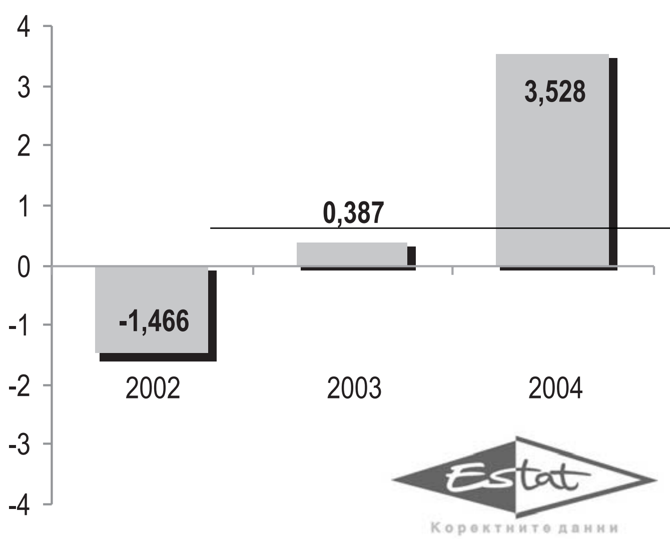
In January, the Estat Index value continued its downward trend reaching a level of 1.74 points. This is the lowest indicator for all of 2004, but at the same time it is the highest winter-time value to be registered since 2002. (Figure10).

Figure 10. Business Climate Dynamics



The dynamics in the course of the three years under review clearly shows the seasonal nature of entrepreneurs' assessments. This makes comparisons between the highest, lowest, and average values by years quite relevant. Such an approach makes long-term trends most clearly visible, and in this particular case, the trend is towards improved business conditions in Bulgaria.

Figure 11. Average values of the Estat index by years



The lower values registered in January are due, above all, to the lower propensity to invest typical of this period of the year. At the same time, the condition of businesses remains stable while the share of enterprises in "good" and in "poor" condition have not undergone significant changes over the past quarters.

The extremely favorable ratio of "thriving" to "sinking" companies continues to be in place – 4.5:1. This shows that positive trends in the condition of businesses registered throughout 2004 also continued in winter months.

Figures reveal that the low values registered in January do not portend economic shocks but are rather the result of caution and restraint on the part of managers. Lower values for investment attitudes should be interpreted as "winter blues" and not as an indicator of companies going through hard times.

The component registering attitudes towards the legal environment, tax rates, government policy, and government regulation remains stable. Differences in values registered in October and in January are equal to mere hundredths, which means that they remain practically unchanged. Figures reveal that, for better or worse, the business community does not harbor any expectations associated with the current ruling majority and is simply biding its time until the "Changing of the Guard" at 1, Dondukov Str.

Condition of businesses

Businesses in "good" and "satisfactory" condition largely prevail. Managers' assessment of the condition of their companies and their outlook for the next quarter are obviously not influenced by the lower investment attitudes.

The share of respondents who believe that their businesses outmatch the competition by all 6 measured indicators continues to rise slowly.

The share of thriving companies (enterprises in good condition whose managers anticipate an improvement) reached the record-high 18.4 per cent, while the share of "sinking" companies (poor condition and anticipated deepening difficulties) remains stable around the minimum of about 4 per cent. In January, the share of thriving companies was even higher than the values registered in July of last year when the Estat index registered its highest value ever.

[8] The survey was conducted in the period 25- 10 March 2005 among 400 companies and is representative at the "going concern" level. The sample criteria included the region, number of employees, and type of ownership. The methodology behind the index and the mathematical model were developed by the Estat Agency for Social and Marketing Surveys.

Figure 12. What is your assessment of the current condition of your business?

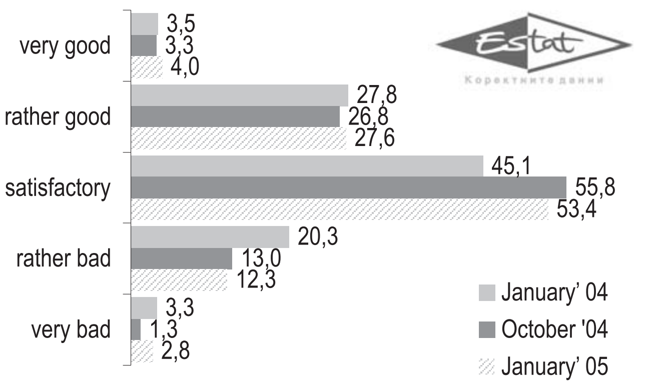
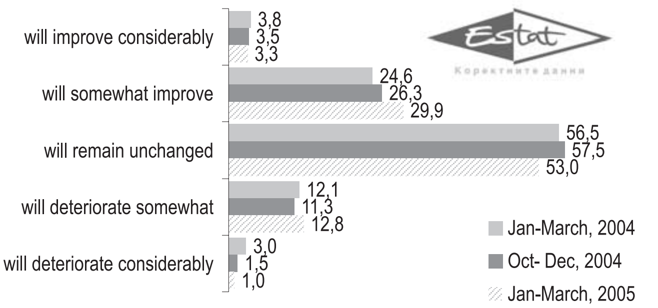


Figure 13. Will the condition of your business change over the next three months?



Investment attitudes

The share of entrepreneurs convinced that selling in foreign markets is the recipe for survival continues to go down, reaching 21 per cent. The attention and confidence in the domestic market and consumption are growing.

The value registering the number of managers inclined to do anything they can to provide funds for investment in their core business/activity is 8 percentage points lower as compared to the previous quarter (80 per cent). This trend is in line with the propensity to focus efforts on the core activity demonstrated over the past months.

The share of respondents according to whom the transport infrastructure has a strong impact on business is rising by 6 per cent (to 52 per cent). Sensitivity to this infrastructure component is probably heightened because of the combination of the traditionally bad condition of roads and the discussions surrounding the concession of Trakia Motorway and the privatization of Bulgaria Air.

A significant new decrease is registered in the share of companies operating in an environment of working capital deficit. In the early months of 2005, 60 per cent of businesses quoted this as a concern, while in October of last year the number of companies suffering permanent difficulties was more than 6 per cent. Only 12 months ago this share was 72 per cent.

Assessment of the Environment

With six months to go before Election Day, the business community shows no particular expectations associated with the ruling majority and government. The surveys even reveal a certain increase in the values registering negative attitudes towards the legislative initiatives of the current cabinet and to the question of whether it promotes business development.

No changes have been registered vis-à-vis sensitivity to tax rates or red tape and corruption levels.

The share of those agreeing with the statement that the banking system is stable and reliable went down 4 per cent as compared to October. This tendency will probably deepen further because of the measures to cut down on bank lending expected in the spring and might undermine the level of trust established between financial institutions and their clients.

The share of managers convinced that unfair competition impedes the development of most businesses in Bulgaria has grown to 85 per cent. This is the highest value ever registered for this indicator.

The share of managers who believe that there is a high likelihood for a business dispute to be settled fairly when it lands in a courtroom has gone down by 4 per cent over the past quarter.

Confidence in the fairness and transparency of procedures under the Public Procurement Act remains within the traditionally critical range.

In early 2005, the following positive developments were observed in enterprise policy:

- The National Innovation Fund started operating.
- Some SME promotion projects were launched and the implementation of others continued.
- Incentives were introduced for Bulgarian investment abroad.
- New SME credit lines were established.
- The concession of some airports and ports was set in motion.
- The Ministry of Economy (ME) continued its efforts to introduce EU standards in certain sectors.
- Preparation to separate company registration from the judiciary continued.
- Activities to counter corruption in public administration were stepped up.

At the same time, the following undesirable trends appeared or deteriorated:

- The adoption of alternative court procedures to alleviate the business-to-business debt recovery is still being delayed.
- Trakia Motorway was granted under concession in transparently.
- The privatization of Bulgartabac Holding failed.
- Performance in the area of easing regulatory regimes and the implementation of ARARACEA for Bulgarian businesses is still inadequate.
- Anti-corruption reforms in the economic sector are advancing very slowly.

Entrepreneurship and SME Promotion

Promotion projects. Three projects for SME promotion were implemented by the MoE during the past months. The first one entitled “Establishing Competitive Start-Up Companies”, also known as *Project 100* – expanded its geographical scope. In 2004 on the territory of Dobrich, Vidin, Silistra and Shumen a total of 67 new enterprises were established and were given grants of BGN 5 000 to 15 000 for start-up activities. This year the project will also cover Montana, Pazardzhik, Sliven and Yambol, with the MoE providing grants of up to 15 000 BGN to competitive projects by start-up entrepreneurs in these regions. An eligibility criterion is for micro- and small enterprises to co-finance the projects by providing at least 20 per cent of the project budget.

The second project concerns the introduction of Hazard Analysis of Critical Control Points systems to assist companies in the dairy sector. The budget for the project for 2005 is BGN 1 million.

National Innovation Fund. The third promotion project – establishing the National Innovation Fund (NIF) attracted special attention. NIF was conceived as an economic policy measure included in the Act on Amendments to the SME Act, which came into effect in July of 2004. Judging from its goals, it may be described as an active enterprise policy measure to support on competitive basis the projects developed by Bulgarian SMEs that feature high added value and innovation capacity. In mid-March 2005 NIF made a call for proposals for projects; the deadline for filing proposals is 5 May 2005. The NIF budget for 2005 is BGN 5 million and it is expected to gradually increase to BGN 13 million in 2007.

Although NIF is officially subordinated to the MoE, it is managed by EASMEP, and the projects will be forwarded either to HQ EASMEP or to some of its regional offices. After the EASMEP Statutes was approved in August, the Agency started opening new offices, hiring staff, and developing guidelines for public-private partnership. According to these guidelines, the new Agency offices will be located at the offices of regional business associations. This will save on the time and cost invested by businesses to communicate with the administration. The Agency will have an office in each city that is a regional centre.

NIF will award grants to projects worth up to BGN 500 000 with an implementation deadline of 3 years or less; there is also a requirement for a certain share of co-financing by the enterprise. Projects will be evaluated following two basic criteria: innovation and economic potential. According to the initial draft of NIF guidelines, the applicants must meet the following requirements: managerial capacity, clear description of project’s activity and budget, awareness of market demand, and expected results and benefits for the enterprise[9].

Commercial Attachés. The protection of the interests of Bulgarian companies developing their business internationally is an important component of the policy to promote SMEs and the export orientation of the national economy. As part of the policy to protect such interests, a practice was established to form public-private partnerships in running the country’s Commercial Attaché offices abroad. The partnership framework foresees that applicants for Commercial Attaché positions would be nominated by employers’ organizations and approved jointly with the Ministry of Economy. Thus employers’ organizations will be able to leverage the efforts, exercise control on the activity of commercial attaches and assist in improving the performance of trade missions abroad.

Diplomatic representatives are not always qualified to protect in the best way the interest of Bulgarian companies and promote them in the country they are posted. That is why the Ministry of Economy took action as early as 2004 to post representatives of the business community in the country’s diplomatic missions.

[9] More information on NIF is available at: http://www.sme.government.bg/bg/inovation/inovation.asp

In early 2005 the first representatives of Bulgarian business at diplomatic missions abroad took over their new functions in four countries: Belgium, the UAE, Kuwait, and Ukraine.

The functions of commercial attachés include promotion of investment opportunities in the country and assistance to companies with export interest in the respective foreign countries. In addition, Bulgaria's commercial attaché to Brussels will have wider powers with respect to aligning the national policy with the EU laws and regulations. This function will also involve providing information on what regulation should be introduced within a given period of time so that Bulgarian enterprises will receive prior notice and align their investment expectations with forthcoming legislative changes. This policy shift will bring down the transaction cost for Bulgarian companies in export-oriented operations and will also serve as a driving force for businesses within the country in terms of streamlining their expectations.

The functions of commercial attachés posted at trade missions abroad will mostly involve providing information and lobbying. It is however unrealistic to assume that they could be used as a marketing channel for all Bulgarian enterprises, intending to export to a given country or to attract investment from within that country.

Investment Promotion

Statistics. In 2004, CED forecasted on numerous occasions that 2004 would be Bulgaria's most successful year in terms of attracting foreign investment. These expectations were justified, as can be seen from the table below.

Table 4. Foreign direct investment in Bulgaria by years, USD m

FDI Source	Year					
	1999	2000	2001	2002	2003	2004
Privatization	226.7	366.0	19.2	135.6	353.5	1189.7
Greenfield investment and reinvestment	592.1	635.5	793.7	769.1	1743.4	1297.8
Total	818.8	1001.5	812.9	904.7	2096.9	2487.5

Source: IBA. FDI statistics in Bulgaria.

http://www.investbg.government.bg/files/1110298086_file.pdf

Because 2004 figures are still inconclusive, according to our estimates the final figures for 2004 will run at USD 3 b with the same level preserved in the course of 2005.

The reasons behind the growing investor interest in the country are to be sought in several aspects. First and foremost, this is the improved business environment. Secondly – the perspective continues that in less than 2 years the economy will join the Single European Market. The third reason is the adoption in 2004 of the Investment Promotion Act. The effect from the implementation of this law will be felt even this year as concerns both re-investment and greenfield investment. Fourth, there are the optimistic expectations of Bulgarian businesses for positive developments in 2005. If the expected introduction of zero profit tax rate for reinvestment of profit, this would serve as an additional incentive for growth in investment and the economy as a whole.

Major investors. In March "Chelopech Mining" EAD became the second company to be issued with a Class 1 investment certificate under the Investment Promotion Act. The company's business plan envisages the investment of another BGN 124,4 m for the period 2005–2007 to expand the existing Chelopech Pit, modernize the ore processing capacity, and introduce new technologies. This will allow for closing the technological cycle for copper and gold production. As a result of the company's expanded activity, the establishment of related production is expected in the region, i.e. the development of a "cluster"[10], accompanied by increased employment opportunities of over 3,000 new jobs. A similar case is the investment planned for 2005 by the Elatsite-Med Company; it will be worth BGN 20 million and is intended for developing the ore extraction and processing complex in the region of the Elatsite copper deposit.

Incentive measures. Alongside incentives to draw fresh foreign investment to Bulgaria, the government also took steps to encourage Bulgarian investment abroad. The Bulgarian Export Insurance Agency (BEIA) introduced investment insurance policies for Bulgarian projects abroad. To be eligible to draw an insurance policy on their investment abroad, enterprises will have to provide proof that it is a new investment or that it is used to acquire ownership in foreign enterprises. In addition, the investment must be long-term (over 3 years), which automatically excludes certain speculative initiatives from the scope of insured investments. The option to draw insurance against political risks such as expropriation, nationalization, and war is seen as particularly positive.

Access to financing

The last few months of 2004 and the beginning of 2005 saw further easing in Bulgarian enterprises' and municipalities' access to financing.

Lending Growth. In spite of the increase in lending by about 45 per cent per year since 2002, banking penetration[11] is well below the EU level. The reasons behind the growth rate of lending to companies and households – in spite of BNB's restrictive measures – could be ascertained in several directions. One of

[10] See below for the subsection on clusters.

[11] Banking penetration - the "bank assets to GDP" ratio. According to information appearing in Bulgarian press it is approx. 65 per cent and is quickly catching up with Central European levels where it is approx. 80 per cent. For EU-15 the ratio reaches 260 per cent. See Industry Watch, "Wealth and Financial Intermediation in Bulgaria", First Quarter of 2005.

the aspects to be noted is the increased available resource of banks as they withdrew their deposits from foreign banks due to the low interest rates there. This was followed by substantial additional credit lines for Bulgarian banks by international lending institutions. Secondly, the privatization of Bulgarian banks made additional resources from foreign parent banks easier to access. Thirdly, local saving was considerably increased thus in turn increasing bank reserves and lending resources. This led to aggressive competition between banks to attract new clients in order to expand their credit portfolios. The role of the newly established *Central Credit Register* should also not be underestimated; all loans, including those worth less than BGN 10 000, are recorded in it. Taking into account the fact that the average amount of consumer loans is BGN 3 000, entering all loans in this register improved risk management in the banking system. This in effect led to a lower credit risk and respectively to cutting risk premiums in interest rates, as well as to a secondary increase in the loan demand as a result of lower interest rates.

Credit lines. New SME credit lines were launched in a number of banks. *ProCredit Bank* opened its SME credit line under an agreement with EBRD. It is in the amount of 10 million euros. Funds available under this credit line will be used to expand lending in remote and underdeveloped regions in the country.

Pursuing the same goals, *Encouragement Bank* started a program entitled “Northern Business Initiative” that is new for Bulgaria. It was introduced under an agreement with the Nordic Investment Bank. Preferential interest rates and security levels will be granted to SMEs whose procurement originates at least 35 per cent from a Nordic country - Denmark, Finland, Norway, Sweden, or from the new Baltic EU Member States – Lithuania, Latvia, and Estonia. The maximum amount of loans will be EUR 1 million, with collateral reaching up to 85 per cent under certain conditions. This is also valid for some of the other programs developed by the Bank in cooperation with the European Investment Fund. The program’s eligibility requirement is that the loan should be used for investment purposes. Precedence is given to projects involving purchase of equipment for production of electricity from renewable sources, purchase of specialized medical equipment, and purchase of vehicles and construction equipment. Special interest preferences will be given to either SMEs co-financed under pre-accession programs, or companies representing the business interests of Nordic countries in Bulgaria.

Interest-free Loans. In 2005, the “Agriculture” State Fund introduced interest-free loans to farmers wishing to purchase new agricultural machinery. The Fund is actually providing loans at the standard interest rate of 6 per cent and along with it also a grant that covers the amount of interest. BGN 12.5 million have been earmarked in this year’s budget for this purpose.

Alongside this measure, during the review period several municipalities in Bulgaria were given easier access to interest-free loans from the national budget. The beneficiaries were municipalities which had projects approved under the SAPARD Program. The Council of Ministers’ decree approving these interest-free loans became effective on 1 April 2005. Preferential loans will cover up to 30 per cent of the total investment. This positive measure in budget policy also holds risks for municipalities’ liquidity. The loans must be repaid to the central budget by 20 December of year in which they were granted.

Business-to-business Debt. Since late 2004, two different options to address the issue of business-to-business debt recovery have been discussed. The first proposal was the adoption of a special law that would provide for business-to-business debt collection by a private Official Receiver. In spite of the many arguments that the adoption of the new law should be sped up, the process is moving too slowly and has not yet entered the stage of plenary deliberations at the National Assembly. The current situation of business-to-business debt shows that it is growing at a rate faster than the investment and GDP growth rate. That is, if currently existing bottlenecks in the institutional design are not removed - in this particular case, if debt collection is not taken over by private Official Receivers, then business-to-business debt could become a barrier to accelerated economic development. This is so because enterprises need resources for fresh investment that are currently blocked by their debtors. It is a well-known fact that businesses in Bulgaria are for the time being mostly making use of internal resources to investment – own capital and reinvested profit. Provided that their internal resources are shrinking due to delayed payments or non-payment, companies’ opportunities to invest are also diminishing. Another proposed solution is to establish a clearinghouse that would keep track and charge mutual liabilities on enterprises’ accounts.

Efficiently functioning markets

In early 2005 the policy to promote competition may be characterized by several positive and one negative developments.

“Trakia” Motorway. The process of concession of the Trakia Motorway deserves a negative evaluation.[12] Although the deal is legal from the point of view of procedure, this does not guarantee its economic effectiveness. The market structure established at the time of the deal provided an opportunity to grant a concession without a tender competition. The “one buyer” model in which the government grants concession to a single contractor chosen by the government itself is a natural reaction to the legitimate options provided by the Concessions Act. The “one buyer” model is however the least favorable situation for the seller (i.e. for the government). This

[12] For more details on the concession of “Trakia” Motorway, see the “Concessions” Section in this chapter; the “Transport” Chapter and Appendix 2 2 to this report.

is so because the government agrees to conditions that reduce revenues that might have been received in a competitive concession procedure while at the same time leaving a certain amount of doubt as to the transparency of the way in which parameters of the deal were reached.

Economic Freedom Index. An important event during the review period is the Bulgarian economy's upward movement in the 2005 Economic Freedom Index published by the Heritage Foundation and *Wall Street Journal*. The Bulgarian economy in 2005 was ranked 52nd among 161 economies rated by this index, which places it in the group of countries with "Mostly Free" economy. This index monitors the development of economies through several indicators, including government intervention, price liberalization, and business regulation. The considerable improvement in the country's rating, by 26 positions within just one year, is a particularly encouraging development.

Mobile Telecommunications. The issue of licensing the third GSM operator was finally resolved in February 2005, after the Supreme Administrative Court reconfirmed the legitimacy of CPC's decision to issue the third GSM license. The central question that SAC had to pass judgment on was whether the issuing of a license represented a case of state aid. SAC confirmed that the issuing of the license was not a case of state aid, a decision that finally established the framework of the mobile telecommunication services market in the country as a market of three players: "MobilTel", "Globul", and BTC.

At the end of March a tender competition for a third-generation mobile operator was held; MTel was the winner, offering BGN 78 million. MTel is expected to start providing third-generation services by end 2006. "Globul" and BTC will also be licensed as third-generation operators but the quality of their services will be initially lower because of the lower technological parameters their licenses provide. The issue of the actual demand for third-generation mobile services in Bulgaria remains debatable. These licenses will hardly start generating profit for license-holders before the market potential of second-generation services is exhausted.

Privatization

Statistics. According to figures supplied by the Privatization Agency, as of 30 March 2005, 10 privatization deals were closed for companies with over 50 per cent of state interest and 20 deals for autonomous parts. In addition, 113 blocks of shares in already privatized enterprises were sold. The total number of deals is 127. Revenues from sales of these shares in companies, autonomous parts, and blocks of shares amount to BGN 650.4 m.

"Major" Privatization Deals. Expectations are that by the end of the term of office of the ruling NMSII-MRF coalition, the contracts for the sale of CHPP- Varna, Ruse, as well as the Boyana National Film Center, will be signed.

On 1 March 2005, the National Assembly approved the Strategy for the privatization of Bulgarian River Shipping. 30 per cent of the company was sold through BSE, and on 22 March 2005 the procedure was announced for the sale of the remaining 70 per cent of company shares. Non-binding offers were filed by 25 April.

The privatization of companies in the military-industrial complex "VMZ-Sopot", "Kintex", "Teraton", the "Bulgaria Air" company, and Navigation Maritime Bulgare did not undergo the expected developments. The National Assembly failed to adopt the privatization strategies and the government did not get political support from their respective political parties to continue the process of restructuring and privatizating these major enterprises.

"Bulgartabac Holding". The future of "Bulgartabac Holding" AD is still rather vague. The failed privatization sale of "Bulgartabac Holding" AD had negative repercussions throughout the investment community and international institutions (the IMF and the World Bank). British American Tobacco withdrew from the deal to buy the three cigarette factories citing the "difficult political environment, which continues to worsen". This again placed Bulgaria on the map of countries in which the conditions for structural reform and privatization are fully dependent on political whims, and political arguments prevail over expert opinions. The pending liberalization of the cigarette market and the removal of high protective duty tax in combination with the heavy general de-capitalization of the company leave little room for optimism.

Political Cycle and Privatization. The development of the privatization process in Bulgaria is directly linked with the cycle of general elections. Several months before Election Day, and also several months after a new government is formed, there is a tendency to delay or freeze privatization deals. The shrinking resource of state-owned companies once again places high on the agenda the issue of the boundaries of structural reform and the future of monopolies, as well as the intentions of political forces in this area. In early 2005 the majority of political forces represented in Bulgarian Parliament finalized their economic programs, including their stand on the development of privatization and concession processes concerning the monopolies and the infrastructure.

Two Post-Election Options. There are two major groups of pre-election economic platforms according to their attitude to structural reforms:

- Center-right (The group of representatives of the "right" and "center" parties). These political parties' intentions involve the withdrawal of the state to various degrees through the privatization or concession of infrastructure sites such as ports, airports, NPP, "District Heating (Toplofikatsia) - Sofia" and BDZ.

- Left Wing. At the other end of the scale are the ideas of the BSP-lead left-wing coalition, which favors structural reform while preserving state ownership. Their pre-election program is definitely in favor of protecting state ownership. It however allows for "private ownership and privatization in areas where this would prove more effective". This and other BSP policy papers include a number of critical remarks towards the previous United Democratic Forces government and the current NMSII government in the area of privatization. According to the BSP's papers, "privatization and private ownership are not a panacea to Bulgaria's economic problems".

It is our firm opinion that delaying or stopping the privatization will adversely impact the comprehensive structural reform and the country's economic development.

Concessions

Airports[13]. At the end of its term of office the government took the first steps towards the concession of public state property. The deadline for filing the concession offers by concession bidders for Varna and Burgas airports expired on 8 March 2005. Four international consortiums applied for the 35-year concession which binds them with the obligation to modernize the two airports in compliance with EU requirements. The winning bidder was the Danish company *Copenhagen Airports A/S*. After the closing of negotiations and the signing of the Concession Contract, the company will pay the initial concession fee in the amount of EUR 3 m. Between 2005 and 2008 the company plans to invest EUR 526 m in the renovation and development of Bulgarian airports. The terminal of Bourgas Airport will be modernized and expanded, and the company will construct a brand new terminal for Varna Airport. The offer's financial parameters include the payment of an annual state fee equal to 30 per cent of the income from concession activities at Varna and Bourgas airports. For the concession period, revenues from concession fees are expected to reach EUR 1.297 b. The concessionaire *Copenhagen Airports A/S* will enter the airports' management after the tourist season is over.

The interest demonstrated in the concession of the airport in the city of Rousse caused the Council of Ministers to pass a decision and empower the Ministry of Transport and Communications to manage state public property in the Rousse Region and also to declare the airbase in Shtraklevo a public use commercial airport. The procedure to select a consultant that will be entrusted to carry out the concession analysis is to be announced shortly.

Opportunities for military airports to be transferred to the Civil Aviation and respectively available for concession will be a matter to be decided by the next government.

Ports[14]. The Ministry of Transport and Communications made a public notice of tender to select a concessionaire for the construction of a new terminal for bulk hazardous cargo at Port Varna-West. The concession will be for a period of 35 years and will involve the construction on an area of 120 decares of a birth to handle tankers, pipelines, installations, and roads, as well as technical equipment and technology for handling chemicals. The minimum amount of required investment is BGN 16 m. It is the Ministry of Transport and Communications' desire to provide the country with a modern specialized infrastructure for handling such specific types of cargo by attracting private investment.

In early March 2005, the tender procedures for awarding concession for a period of 30 years of the port terminals Lesport-Varna and Somovit-Rousse were also announced. The two terminals are public state property and are the first ports to be open for concession. The anticipated private investment (at least BGN 7 m for the first 10 years from the concession of the Lesport port and BGN 3 m for Somovit) will help improve the quality of services, increase the productivity and efficiency of cargo handling, and serve to attract new port users.

Beach strips. The concession of parts of the beach strip still continues. For the 20-year concessions of three Black Sea beach strips - "Arapya", "Primorsko-Center" and "Bourgas-North", the winning Bulgarian companies will invest BGN 6 843 900.

The Ministry of Regional Development is expected to organize tender procedures for another two sites: "Kranevo-Center" and "Bourgas-Center". As part of the concession rules, the companies will have to clean and develop the beach strip, provide lifeguard and medical services, and waive entrance charges.

Ores and mineral deposits. In the field of mining and processing industry, the Ministry of Economy announced that only in 2004, BGN 10 482 000 in concession fees were transferred to the state budget under concession contracts. For the period from 2000 to 2004, the amount of revenues from 34 concession contracts was in excess of BGN 120 m. As a result of these contracts, over 70 mining and processing complexes are now functioning in the country providing over 5000 permanent jobs in activities such as mining and primary processing of ores and industrial mineral raw materials. The biggest investments in the mining concession sites in 2004 were made by "Chelopech Mining" EAD – 10.7 million US dollars, "Asarel Medet" AD - 10.1 million US dollars, "Elatsite-Med" AD – approx. 9 million US dollars, and "Kaolin" AD – BGN 3.3 m.

[13] See also "Transport" Chapter.

[14] See also "Transport" Chapter.

The process of concession for ore and mineral deposits is haunted by numerous problems. The Minister of Energy warned the concessionaires of the "Mina Stanyantsi" AD, "Mina Bieli Breg" AD, "Mini Otkrit Vagledobiv" EAD and "Mini Chukurovo" AD to pay the concession fees due for the second half of 2004 or face actions to terminate the concession contracts.

Road infrastructure. According to the provisions of the Concessions Act, the deadline for endorsing the government-approved Contract with the Bulgarian/Portuguese consortium "Avtomagistrala Trakia" (Trakia Motorway) expired on 15 March. By Decision of the Council of Ministers of the same date, the deadline was extended to 1 April 2005.

The contract for awarding concession of the "Trakia" Motorway for a period of 35 years was signed on 29 March. Following heated debates in Parliament and objections by the opposition as to the economic appropriateness of the concession contract, the following parameters of the concession were made publicly available:

The concessionaire, "Avtomagistrala Trakia" AD, is a consortium of two state -owned Bulgarian companies: "Avtomagistrali" and "Tehnoexportstroy" holding 49 per cent of shares, and three Portuguese companies: *MSF-Moniz da Maia, Serra&Fortunato-Empreiteiros*, S.A., Lisbon, Portugal, *Lena Engenharia e Contrucoes*, S.A., Fatima, Portugal, and *Somague Concessores E Servicos, S.A.*, Sintra, Portugal, holding 51 per cent of the shares of the newly incorporated company. Its capital is BGN 1.21 m.

EUR 590 m will be invested into the construction of the motorway by end 2007 and another EUR 125 m by end 2009. 10 per cent of the funds needed to implement the investment program will be provided by the concessionaire and the remaining 90 per cent will be bank loans without government guarantee. Currently, 182 km of the "Trakia" motorway have been constructed, and the concessionaire will construct the remaining 261 km. The motorway's total length is 443 km. The deadline for finishing the construction of the motorway is 2009.

For the contract to become effective, the following conditions need to be in place:

- a positive decision by the Commission on Protection of Competition;
- the written agreement of the European Investment Bank to include in the concession two motorway sections currently under construction;
- a Eurostat statement that the investment will be recorded on the concessionaire's balance.

Preparation for the Single European Market

Standards and New Ordinances. According to EU regulations, each acceding country must submit and justify a list of foodstuffs that are of "traditional specific character". These foodstuffs must have a traditional specific character, i.e. it must be proven that they have features which distinguish them clearly from other similar products or foodstuffs and that they represent a traditional product for which, for a period of at least 50 years, traditional raw materials, ingredients, recipes, and production and manufacturing methods have been followed. For this purpose, in early March the Ministry of Agriculture and Forestry adopted Ordinance № 7 on taking in applications and compiling dossiers and keeping a register of foodstuffs of a traditional specific character for the country or an individual area. The Ministry of Agriculture and Forestry started a procedure of taking in applications to register such foodstuffs in an official list to be submitted for approval in Brussels. Such applications may only be filed by a group of producers consisting of two or more companies.

Consumer Protection. Consumer protection within the single market is one of the key priorities in market regulation within the EU. This will introduce new requirements for Bulgarian producers. With the accession date of 1 January 2007 getting closer, not just exporters but also companies working exclusively for the domestic market are becoming more aware of the need to take urgent measures to introduce the standards of good manufacturing practices and the Hazard Analysis of Critical Control Points (HACCP) system. Significant investment is also needed to bring product packaging and labeling in compliance with EU requirements. Under a PHARE project planned to be launched during the second half of the year, small and medium-sized enterprises will be given up to EUR 50 thousand to cover investment related to meeting EU standards and requirement compliance.

Trade policy

Bulgarian Export Insurance Agency (BEIA). Since late last year two new key measures in the area of export promotion have been introduced. First, *the insurance capacity* of the Bulgarian Export Insurance Agency was increased to the maximum possible index of 10. This means that the Agency' insurance capacity is no longer limited to the amount of budget resources as was the practice until recently. Thus the gross insurance capacity for 2005 will reach BGN 115.47 m. This will create an opportunity to provide new products. One of them involves the insurance of Bulgarian investment abroad. The insurance covers any loss suffered by a Bulgarian company on the territory of another country while doing business there. It provides an opportunity for Bulgarian companies and capital to penetrate a number of markets that were heretofore considered "risk markets".

Since March BEIA also provides *insurance of letters of credit*. It covers performance bonds, participation in a tender bidding or competition, advance payment and other types of letters of credit related to the execution of export contracts. This insurance type allows export companies to be given more favorable terms to finance their export activity. It provides additional security also to banks and increases the value of their collateral. It must be kept in mind that in compliance with BNB Ordinance № 9 on insurance policies, BEIA insurance policies are classified as "risk-free collateral".

Administrative and regulatory environment

Company registration. In spite of the business community's improving opinion on the process of company registration[15], the issue of its further easing remains. On this issue, efforts to draft a Strategy for a Centralized Electronic Register are still continuing. Its adoption and implementation will result in faster company registration in the country, which is still not sufficiently effective, reliable, nor transparent and is often mired by corruption. By its nature, this activity does not involve law enforcement and is therefore an unnecessary burden to the judiciary establishment. That is why proposals to take this activity out of the courts and turn it into a purely administrative procedure entrusted to a centralized agency were for the first time voiced a long time ago.

The solution to this problem involves setting up a centralized register of legal entities and an Electronic Register Center. As early as April 2004 a taskforce was set up to draft Strategy for establishing a central electronic register. Currently efforts are at the stage of coordinating the draft strategy with individual ministries, and it is expected to be adopted by the Council of Ministers by mid-year. Following its adoption, work will commence on drafting the specific implementing legislation.

The Strategy envisages a state-run central electronic register kept with the Registry Agency under the Ministry of Justice. The central register will include the registers of all legal entities, civil registries and real property, registered pledges, and the registry information of Citizen Services (GRAO) and Traffic Police (KAT).

The Strategy introduces several basic principles that will bring about the transition of registration procedures from the courts to public administration. These are:

- unified, standardized, and centralized register;
- cheap and fast registration;
- simplified and reliable procedures;
- electronic databases;
- public Internet access;
- unique identification numbers for each entity/individual.

The creation of an electronic register will result in saving considerably on businesses' and citizens' time (currently most registration procedures take up about 30 days). Another important positive effect is the significant cutting down on corruption and fraud opportunities.

Alleviating regulatory regimes. In spite of the measures to ease regulatory regimes, results in this area are still unsatisfactory. According to a study carried out by the World Bank's Foreign Investment Service, presented by the Institute for Market Economics in March and devoted to the regulatory environment in 9 SEE countries and some former Soviet republics, entrepreneurs in Bulgaria waste about 25 per cent of their time communicating with the administration. About 4.8 per cent of the businesses' turnover is set aside for illegal payments.

The Act on Restricting Administrative Regulation and Administrative Control on Economic Activity[16], that was expected to result in a significant improvement in the regulatory environment unfortunately does not seem to yield the desired results. This mostly applies to its key, and most radical, provisions - the implementation of the "tacit consent" concept and the "one stop shop" services. These aspects of the law are almost never applied in practice or are being applied for form's sake. More than a year after the law came into effect, not a single company has succeeded in obtaining its legally established rights. 21 cases have been filed with the Supreme Administrative Court against various central and local government institutions for failing to abide by the law; however none of these has been finalized to date. The reason for the unsuccessful enforcement of the law lies with its own deficiencies: for example Art. 28 stipulates that tacit consent can be applied for one-time deals "unless otherwise provided", without specifying however how it "otherwise" should be construed - which opens the way to widely varying interpretations. This calls for a change to make texts in the law more precise. In addition, the law is not known to both the business community and the government officials who were not specially trained to implement it.

Measures to improve the law itself are necessary in order to communicate clearly its provisions to government officials and entrepreneurs and provide for its strict enforcement. Apart from this, according to business representatives, the 39 licensing regimes stipulated in the law are too many and their number must be cut – it is possible for at least 10 regimes to be simplified or removed.

Urgent changes are also necessary in the administration's operational guidelines which currently include unclear implementing procedures and give bureaucrats the right to postpone and draw out the proceedings, thus wasting clients' time. Another instrument that will considerably speed up administrative performance is the adoption and implementation of unified standardized forms for individual procedures.

15 Investment Compact-OECD. Bulgaria Enterprise Policy Performance Assessment 2004, p. 23

16 Adopted on 4 June 2003 and in force since December, 2003

Additional options. An important aspect of easing the regulatory environment is related to the decision taken in March by the Public Administration Council. It foresees for a considerable portion of administrative services to be transferred to the private sector. The proposal involves 40-60 types of services mostly in the area of veterinary medicine, transport and communications, agriculture, and forestry. The issue of establishing public-private partnership in the area of administering various types of services was put up for discussion a long time ago also by business representatives. The decision, which is expected to be implemented in 2006, will probably result in saving time, less corruption, and a considerable cut in red tape and public administration costs.

Reform in public administration. The reform in public administration is closely linked to improving the administrative and regulatory environment for businesses. A policy paper entitled White Book of Public Administration that was officially presented in March is an important step in that direction. It formulates the key guidelines for modernizing the administration. It provides a mechanism to maintain these guidelines in the years to come regardless of what government will be ruling the country. The goal is to achieve continuity and sustainability in implementing administrative reforms. The key priorities and policy lines in this field are outlined.

The White Book emphasizes that client-oriented practices must be given a priority when planning, managing, and evaluating the process of modernization of public administration. This means reconciling economic efficiency with public interests (of both citizens and businesses). Achieving this would first require developing clear quality standards, setting strategic goals, and controlling the implementation of objectives by comparing the actual results on the basis of predefined criteria. The purpose of such strategic control is to evaluate the impact of the public administration's activity by applying valid criteria for improvement of the administrative services' quality. This would provide an opportunity to ask the correct question in administrative servicing, namely: *"Are we doing the right things" instead of "Are we doing things right"?*

It is also necessary to reduce the number of civil servants. A recommendation to that effect was also put forth by EU officials – in all probability public administration will be reduced by 5-10 thousand people, which would move the country closer to the optimum necessary staff.

Also in the pipeline are amendments to the Public Administration Act, one of which envisages the creation of an inspectorate to review financial and disciplinary violations and to assist in reducing the corruption practices within public administration.

Public Procurement. The 6 months that have elapsed since the coming into force of the new Public Procurement Act in October 2004 allow for an evaluation of its effectiveness and for analysis into some of the problems quoted by the business community.

According to business representatives – Employers' Association and the Bulgarian Industrial Association – the new Public Procurement Act creates several groups of problems. In the first place, the law is not efficient enough and leads to corruption practices. In spite of the fact that the law, to a very considerable degree, introduced in Bulgaria the same rules and requirements for public procurement as the ones applied in the EU, part of these provisions are in effect not being implemented in the country. According to employers, the key reasons for the first group of problems are related to several circumstances:

- the contracting entities often formulate their technical requirements in a way that only a limited number of companies, and in some cases only one company, meet the requirements;
- the contracting entities apply unclear criteria to evaluate the tender offers;
- as part of the evaluation and selection of the contractor, the criteria can be interpreted in various ways, usually in favor of a given tenderer with whom an arrangement was made in advance.

In this way the competition between tenderers is in fact bent unfairly.

The second major problem occurs when dealing with "related persons". It is not acceptable for several related persons to take part in the same procurement procedure under the PPA. Currently such practices are an infrequent occurrence. According to employers, the participation of related persons as tenderers in the same PPA procedure must be banned; another situation that must be legally prohibited is for contracting entities and contractors to be related persons in the same procedure.

A third serious issue is the enforcement control which, according to BIA, is insufficient.

A fourth serious issue in the new law arises from the short deadline for taking in tender offers – 27 days. Contracting entities apply this deadline indiscriminately, without taking into consideration the scale and complexity of the procurement. When large-scale projects are involved, this deadline is utterly inadequate. In such cases the contracting entities provide information in advance to a company of their choice, and it subsequently has more time for preparation than its competitors, thus placing it in a privileged position. This deficiency could be avoided by setting the deadlines depending on the complexity and scale of procurement.

A fifth serious problem is linked to the continuing difficulties in the appeals process – the new law foresees an opportunity for appeals to be brought before the newly established Court of Arbitration at the Public Procurement Agency. The court however doesn't yet have an elected Chairman and hasn't settled a single dispute at present.

A sixth problem associated with the law is that it is being ignored. For the 6 months since it has come into force, it has become clear that small contracting entities such as municipalities and hospitals often knowingly use short cuts to circumvent it.

Therefore changes are necessary to improve the law. Changes are in the pipeline anyway: starting 2006, two new public procurement directives will come into force in the EU, and this will necessitate changes in the Bulgarian law, as well. All proposals for corrective measures are expected to be in place by September 2005.

Public Procurement Register. Work on the new Public Procurement Register is ongoing. It is expected to become operational in its final version in late April 2005. According to figures supplied by the Public Procurement Agency, for the period 1 October 2004 to 6 April 2005, 3563 announcements were published in the new Public Procurement Register (PPR), of which:

- 1455 under PPA,
- 2108 "small" public procurement below the thresholds[17] of the PPA.

Under the procedure the procurement types are:

- open procedure - 1615 notices (45.3 per cent),
- restricted procedure - 834 notices (23.4 per cent),
- negotiated procedure with prior publication of a contract notice – 436 (12.2 per cent).

The contracting entities include:

- municipalities - 1013 notices (28.4 per cent),
- ministries and agencies – 649 notices (18.2 per cent),
- public legal organizations – 617 notices (17.3 per cent),
- healthcare establishments - 545 notices (15.3 per cent).

The public procurement contracts signed between 1 October and 6 April are 1081 worth BGN 329.5 million, VAT excluded. This brings the signed contracts (1081) to notices (3563) ratio at 30.3 per cent.

Currently the opportunity is being discussed for PPR notices to fully replace those promulgated in Official Gazette, with electronic forms replacing the paper documentation. This would facilitate contracting entities in entering the information, and will also make it easier for companies to access this information. After the current beta version of the Register is finalized, procurement offers will be filed via the Internet which will help reduce corruption practices. The information entered in the Register will improve in terms of completeness and comprehensiveness (one of the most serious deficiencies of the old register was the incorrect and incomplete information filed by the contracting entities).

The new register will cover all types of procurement – both PPA and "below the thresholds" procurement. In compliance with EU directives, a procurement classifier, standardized notice forms, and unique account numbers for contracting entities have been set up. These measures will result in the improved quality, comprehensiveness, and truthfulness of information in the register. This is a prerequisite to enhance controls over the data input to the Register. The final version of the Register is planned to enable contracting entities to enter new information online using electronic signatures for this purpose.

Fight against corruption. The past several months saw stepped-up anti-corruption initiatives and activity both by civil and business organizations, and by the government. At the end of February, the government adopted *an amendment to the National Strategy against Corruption*[18]*.* The text includes a new section prescribing measures to counter corruption "at the top" of the government establishment. These include:

- drafting a Code of Ethics for Ministers and political officials in the executive branch. According to the Secretary of the government Anti-Corruption Coordination Commission, Mr. K. Palikarski, the document[19] will set the rules and provide lists regulating what Ministers, Deputy Ministers, Chief Secretaries, and members of political cabinets may and may not accept in the form of gifts.
- providing training to members of political cabinets, the directors of state and executive agencies, and members of state committees on the issues of corruption, conflicts of interest, and professional ethics.
- establishing a Joint Council of government and business community representatives to cut down on corruption among entrepreneurs and senior government officials.
- introducing a policy to encourage businesses that actively work to counter corruption practices.
- improving control on spending financial resources under European funds and in concluding and implementing concession contracts.

Another step forward in the fight against corruption was the public and political forum organized on 22 February 2005 by Coalition 2000. Participants in the seventh forum discussed

[17] These thresholds are respectively BGN 1.8 m for construction works, BGN 150 thousand for supplies and BGN 90 thousand for services.

[18] CoM Decision № 223 of 30 March 2005.
(See.: http://www.anticorruption.bg/bg/coalition/act_1580.tif)

[19] It is appropriate to remind the reader that for the time being such rules are only in place for public administration officials. The CoM Decision #126 of 11 June 2004 Code of Conduct for public administration officials (See. OG, iss. 53, 2 June 2004) states that the official must not "request and accept gifts, services, money, benefits or other privileged treatment that might bias the way he/she discharges of his/her obligations or decisions or disturb his/her professional approach to certain issues".

the annual corruption assessment report for 2004 “Anti-Corruption Reforms in Bulgaria”[20]. It provides an analysis of the spread of corruption, the level and dynamics of corruption in society. Key achievements and issues in the fight against corruption are presented, as well as present-day challenges to anti-corruption reforms associated with EU accession: overcoming the structural and institutional barriers in the fight against corruption; the efficient functioning of the judiciary and law enforcement system; and cutting down on the corruption-generating organized crime and “grey” economy.

A positive trend towards lower levels of “petty” and administrative corruption registered after 1997. At the same time corruption in the business sphere continues to pose a serious problem, as anti-corruption reforms in the business sector are still developing too slowly. As a whole the spread of corruption in this area is over twice as high as in the public sector. At the end of 2004 there were some “red flag” warnings on the increase in corruption deals and their scale. This is an indicator of the need to strengthen existing anti-corruption policies, programs, and initiatives.

Corruption is still one of the key long-term risks for Bulgaria’s European Union integration. It negatively impacts economic development by generating institutional unsustainability, and impedes the implementation of the EU’s common rules and policies, thus increasing the risk of fraudulent and ineffective management of European funds.

The key aspects to continue the fight against corruption include:

- Strengthening efficiently functioning democratic institutions.
- Priority implementation of anti-corruption reforms in the judiciary branch and the law enforcement institutions.
- Strengthening the market economy institutions that stimulate the rational and legitimate economic behavior of economic agents.
- Cutting down on criminal structures and the infiltration of organized crime groups in the structures of government and economic life.
- Activating and enlarging the scope of civil counteraction to corruption.

New anti-corruption initiative. Business representatives are also stepping up a fight against corruption. In February 400 companies that are members of the Bulgarian International Business Association (BIBA), the Bulgarian Business Leaders Forum, and the Bulgarian Business Tourism Bureau published a Declaration[21] against corruption. Signatories included foreign investors, banks and insurance companies, retail chains, industrial enterprises, importers and exporters, and business associations. Entrepreneurs point out that corruption in all of its forms can only be eradicated through the consistent efforts of the business community and the government.

Business representatives proposed a partnership to the government towards the implementation of a number of measures to streamline the fight against corruption at all levels and all areas of public administration. Entrepreneurs proposed the adoption of the following measures: introducing e-government; ensuring full transparency of public procurement competitions; adoption of a Lobbyism Act; introducing higher selection criteria for public administration officials, providing them with adequate remuneration rates, and introducing mandatory training for civil servants in countering corruption; establishing an independent body under the Council of Ministers to investigate cases of alleged corruption; improving the accountability mechanisms for government institutions; public discussion of all pieces of implementing legislation that might encourage corruption practices; and support by non-governmental organizations active in the field of anti-corruption, as well as by international agreements and initiatives to establish a corruption-intolerant environment.

For their part, entrepreneurs undertook: to disseminate in the business community the policy of intolerance to all corruption forms and manifestations; to encourage their partners and subcontractors to sign the Declaration; to introduce the signing of anti-corruption contracts with their subcontractors, partners, and employees; to ensure complete transparency for their public procurement offers; to achieve a high level of awareness among their employees regarding certain aspects of corruption, including: conflict of interest, gifts and privileged servicing, political donations, commissions, and others; and to encourage and provide protection to employees and partners revealing information on corruption practices.

[20] Coalition 2000. Anti-corruption Reforms in Bulgaria, S., 2005

[22] http://www.anticorruption.bg/bg/news/events.php?event=0&id=5118&place=3

Budget execution as of the end of February 2005.

Consolidated Budget[22]. As a whole, early 2005 registered a good rate of execution under the consolidated fiscal program with many items registering an increase when compared to average estimates in Budget 2005. According to figures from the Ministry of Finance, as of 28 February 2005 the surplus under the consolidated fiscal program reached BGN 134.4 m.

Table 5. Budget surplus/deficit for the respective year (in million BGN)

	Date		
	28 February 2003	29 February 2004	28 February 2005
Amount	- 147.5	- 149.5	134.4

Source: According to figures from the Ministry of Finance, "Budget" bulletin.

Data comparison for the three consecutive years shows that the estimates we made at the end of 2004 for a budget surplus of approx. BGN 2 000 m. in 2005 are about to come true. Unfortunately, this year, too, the surplus will be most likely spent on pre-election gimmicks and/or the new government, which at the end of this year will pour a torrent of money into unplanned, low-efficiency spending, as was the case at the end of last year.

Moreover, the approved 2005 Budget does not correspond in any way to the economic priorities declared by the government late last year, one of which was to seek opportunities for accelerated economic growth. The incentives for businesses and individuals that the government included in the 2005 Budget are at least 1.5 to 2 years too late. This is evidenced by the fact that even with the new tax preferences, the first two months of the year generated a surplus of BGN 134 m.

Analysis shows that 2005 could lay the foundations and even successfully resolve some of key problems faced by Bulgarian businesses: (1) decrease the social security burden, incl. feeding BGN 1 000 m into the pension insurance system, (2) involve the state as co-payer of social security contributions by paying approx. 30 to 40 per cent of due contributions, (3) levy zero corporate tax on reinvested profit, (4) levy a 5 per cent tax rate on corporate profit for all public companies traded on the stock exchange, or (5) lower the tax base for individuals by 10 per cent for investment in shares of publicly traded companies.

Revenues and aid at the end of February 2005 reached BGN 2 536.1 m. as compared to BGN 2 110.6 m. in 2004. The basic reason for the good rate of execution on the revenue side, just like the preceding period, is entirely due to the better collection rate for tax and non-tax revenues, regardless of the tax relief measures.

Expenditures for the period amount to a total of BGN 2 401.7 m., as compared to BGN 2 260.2 in the same period of 2004.

With respect to spending structure of the budget, the largest relative share of expenditures is with the national budget and the social security account, with the largest items respectively being interest on foreign and domestic loans – BGN 336.4 m. and BGN 814.0 m.

Based on the above, it is possible to project an increased surplus under the consolidated fiscal program in the course of the next few months due to the fact that there will be less spending on interest rates. In January 2005, payments amounted to a total of BGN 270.0 m., as compared to BGN 66.7 m. in February 2005.

National budget[23]. There is a *surplus* in the amount of BGN 45.9 m. in the national budget for this period. Revenues and aids account for BGN 1670.6 m., while expenses and transfers amount to BGN 1063.0 m. The detailed analysis of figures reveals that revenues are mostly generated from tax proceeds while expenditures consist mostly of running costs and interest payments.

Central budget. At the same time, the central budget deficit is in the amount of BGN 67.4 m., with revenues and aids amounting to BGN 1 404.5 m. and expenses and transfers - BGN 371.6 m. and BGN 1 100.3 m. respectively.Analysis of these figures shows that there is an enormous difference in the amount of revenues over expenditures, which is fully compensated by the transfers made.

Fiscal reserve[24]. The trend for continuous increase of the fiscal reserve has now changed, and reserve funds have decreased to BGN 4 193.5 m. as of 29 February 2005. As of the same date, a decrease is registered in the amount of fiscal reserve funds in BNB deposits – BGN 3 755.9 m. and increase in the funds in foreign currency deposits – BGN 2 964.0 m.

[22] The consolidated budget covers the national budget and all autonomous budgets – those of local governments, insurance funds, state universities, Bulgarian Academy of Science, Bulgarian National Radio, Bulgarian National Television, Supreme Judicial Council, as well as extra-budgetary funds and accounts on the central and local level.

[23] Comprising the central budget, budgets of ministries and agencies, and the budget of the Audit Office.

[24] Covers cash in BGN and foreign currency on all current and term deposits with the BNB and commercial banks of the central budget, the budget funds of ministries and agencies, the National Social Security Institute, the National Health Insurance Fund and their extra-budgetary accounts and funds, as well as other high- liquid low-risk financial assets in foreign currency of the government.

Table 6. Indicators of the fiscal reserve (FR) according to the Agreement with IMF (BGN m.)

	As of 31 October 2004	As of 30 November 2004	As of 31 December 2004	As of 31 January 2005	As of 28 February 2005
Total amount of FR	5835.3	5889.8	4810.6	3824.6	4193.5
FR funds in BNB deposits	4897.8	5383.9	4346.0	3369.8	3755.9
FR funds in foreign currency deposits	2851.2	3225.7	3720.2	2687.5	2964.0
High-liquid financial assets	414.7	-	-	-	-

Source: MoF data.

Note: For the purposes of the program, deposits and assets denominated in foreign currencies, are recalculated in BGN at the official exchange rate for the respective currencies as of 31 December 2004. (BGN 1.43589 and SDR 1.55301 for one US dollar).

Regardless of the fact that part of the fiscal reserve was used for prepayment of foreign debt, the reserve amount is still significant. In this way, the government did not succeed in introducing regulation to provide a legal framework for fiscal reserve management, this continuing to be a major governance gap.

This is the appropriate time to point out that the formation of a budget surplus combined with high fiscal reserve values allows for developing and implementing a more proactive growth policy.

Municipal finance. As of 28 February 2005, municipal budgets registered a **surplus** in the amount of BGN 72.0 m., calculated from the difference between revenues and aid (BGN 114.3 m.), spending (BGN 314.2 m.), and net transfers (BGN 272.0 m.).

Revenue side of the national budget

Tax revenues for the national budget as of 28 February 2005 were in the amount of BGN 1,414.7 m. as compared to 1,73.9 m. on the same date of last year. Collection at end-February was 16.1 per cent of estimates in the National Budget Act.

In essence, there is a continuing trend for over-execution of tax revenues as compared to budget estimates, regardless of the number of tax relief measures introduced since the beginning of 2005. This re-confirms the point discussed earlier in this paper that reforms in the budget sphere are 1.5 to 2 years too late; the lack of a less conservative approach to the revenue side of the budget results in collecting higher-than-necessary tax revenues from businesses and individuals, i.e. the economy is being artificially burdened and its growth is thus restricted.

The largest relative share continues to be that of **VAT** - 41.6 per cent of total revenues or 49.1 per cent of tax revenues. As of 28 February 2005, a 16.4 per cent execution of this type of tax is reported as compared to the amount projected in Budget 2004.

The key reasons behind this increased collection rate for VAT (regardless of the number of unresolved issues with the so-called VAT-chains and ghost companies) are:

- the structure of VAT revenues where a trend of increased import of goods into the country is being observed;
- the improved competence of the tax administration and the preventive measures against tax fraud including the criminal persecution of such acts.

It is worth noting that Budget 2005 estimates a growth in VAT revenues by approx. BGN 900 m. The tax rates are unchanged, yet collection rates continue to run high. We can therefore conclude that this year there will be an over execution of revenues for tax. Provided that this tax accounts for about 50 per cent of all tax revenues, over execution of tax revenues is to be expected this year too.

At the same time, a clear tax policy schedule should be developed that would guarantee the revenue side of the budget while seeking to provide businesses with maximum incentives. There are two possible options:

1. to reduce the VAT rate;
2. to keep the VAT rate at 20 per cent, while creating additional tax preferences in direct taxation. It is possible to regulate a 30-day tax credit refund for export companies as an incentive.

The excise duty and charges on liquid fuels also feature a high relative share, in the amount of BGN 323.8 m., which accounts for 19.4 per cent of the total national budget revenues and 22.21 per cent of the amount of tax revenues as of 28 February 2005. There is an increase both in absolute terms and as a percentage of execution; for the first two months, the tax collected is about BGN 100 m. more as compared to the same period of last year. These figures clearly show the continuing upward trend in imports.

The personal income tax (PIT) as of 28 February 2005 has a relative share of 11.8 per cent of the total revenues and 13.9 per cent of tax revenues. This also represents a good rate of execution. Because of the fact that the bulk of revenues from this type of tax for the period is generated from labor and service contracts governed by new tax relief for 2005, two conclusions can be drawn:

- it is possible to introduce additional tax preferences mostly in the higher tax brackets - this is confirmed by the fact that the absolute amount of revenues from this type of tax is permanently growing;
- the tax paid prior to 15 May 2005 (deadline for payment of tax for all individuals working under non-labor contracts and sole proprietorships (ET)), suggests that bigger tax relief could have been possible also in previous years, i.e. the tax relief for 2005 could have been introduced at least since the beginning of 2004; this would result in increased individual incomes, serve as an incentive for seeking additional income, and would generate more free resources for ET.

Corporate tax. The share of revenues from corporate tax as of end-February 2005 was 5.4 per cent of the total revenues and 6.4 per cent of tax revenues, amounting to BGN 90.0 m., or a 9.8 per cent execution of the projections specified in the National Budget Act for 2005.

In essence, there is a corporate tax cut from 19.5 to 15 per cent, which should serve as an incentive for businesses. The low execution of revenues in percentage terms as compared to other taxes should not be interpreted one-sidedly, because a number of tax law provisions allow businesses not to pay advance tax during the first months of the year or to pay lower tax. At the same time, the bulk of revenues will be generated at the end of March, when the deadline for payment of the corporate tax for 2004 expires.

The issue of further cuts in corporate tax rates is becoming more prominent. The relative share of this type of tax in total revenues is under 10 per cent. Analysis shows that with the crossing of the psychological barrier of 10 per cent for corporate tax, the share of taxpayers who would go “above ground” and declare their actual profit will grow dramatically: it would simply not be worth their while to pay consultants in order to seek tax avoidance schemes and worry about tax authorities finding faults in a possible audit.

Duty tax. Revenues from duty and customs fees were in the amount of BGN 40.0 m., which is an execution of 24.1 per cent as of 28 February 2004. These very modest revenues have a relative share of 3.1 per cent of total revenues and 3.7 per cent of tax revenues.

These results are best explained by the increased rate of imports in the country, as well as the improved performance of the customs administration. Starting this year, the excise duty on spirits and beer was increased; the structure of excise on cigarettes was also changed. The over execution is in part due to the enormous quantities of sugar and oil already imported in January.

Dividend and income tax. Revenues here in the amount of BGN 14.4 m. report an execution of 23.6 per cent as of 28 January 2005. These results show that the decrease from 15 to 7 per cent of the dividend tax could have been regulated as early as 2 years ago, because the same revenues account for under 1 per cent of the amount of tax revenues. The effect of this tax relief measure will be registered no earlier than the beginning of next year, when dividends are expected to grow.

A more detailed analysis shows that the dividend tax could be eliminated entirely, which in combination with the corporate tax cut to 10 per cent would result in establishing a tax environment that would create an incentive for Bulgarian business.

Non-tax revenues to the national budget reached the amount of BGN 253.2 m. as of 28 February 2005, which is 15.6 per cent of Budget 2005 estimates. The amount of state fees is to be given special attention; its execution is 26 per cent only for the first two months of the year. This shows that many of these should be reviewed and reduced or eliminated. Many entrepreneurs quote the existence of numerous fees as a major problem.

Regardless of the large-scale and successful tax reforms highly advertised by the government to create incentives for businesses and simplify the tax system, the data and analyses quoted above demonstrate that opportunities to decrease the tax burden are not fully and promptly used.

Expenditures side of the national budget

Gross Expenditures. Expenditures made prior to 28 January 2005 amount to BGN 1 063.0 m. as compared to BGN 1 040.7 m. for the same period of 2004.

Operating/Administrative costs. The largest relative share of total expenditures are the administrative costs in the amount of BGN 349.2 m., incorporating expenditures for medications, fuel, energy, hired services, current repair, and also defense and security expenditures.

Interest. Due interest on foreign and domestic loans, which are in the amount of BGN 336.4 m. are also a point of focus (BGN 284.7 m. on foreign and BGN 51.7 m. on domestic loans).

Subsidy. With respect to subsidies, a decrease of BGN 63.2 m. is registered as compared to the same period of 2004.

Social expenditures and scholarships in the amount of BGN 126.3 m. register an execution of 15 per cent of estimates. The trend for non-execution of government commitments in this field continues.

Net Transfers. Net transfers, the difference between transfers made and received from the national budget, are within the projected amount, reaching BGN 561.7 m. and represent an execution of 17 per cent. The transfers to social insurance *funds* could be quoted as an exception. These are in the amount of BGN 218.1 m., with execution running at 20.1 per cent of the estimates in Budget 2005.

Future Directions of Fiscal Policy

Budget 2005 approved by the Ministry of Finance declares that it is in line with the internal policies and principles in the government's program for achieving the key national priorities: (1) long term economic growth; (2) tax cuts for key taxes; (3) income growth; (4) efficient spending; and (5) setting appropriate objectives for the budget deficit level.

Unfortunately, all of these objectives were achieved only to a certain extent. Although the foundations of long-term economic growth have been laid, growth rate has not been high enough to match the challenge posed by EU accession– our estimates show that Bulgaria needs a growth rate of about 8-10 per cent per year in order to reach European levels of incomes and productivity and not the currently projected growth of 5.5 to 6 per cent.

Although there have been tax cuts for key taxes, these were rather belated (as we discussed earlier, 1.5 to 2 years too late), and it is absolutely inappropriate to claim that these tax cuts are enough to adequately stimulate economic growth. A major argument to prove this could be the continuing budget surplus in spite of the tax preferences granted during the past several years.

Program budgeting lacks the objectives and estimates on the level of a given expenditure item. The government declared in Budget 2005 its key priorities in the following areas: healthcare, defense and security, and the judicial system.

With respect to healthcare, the level of public discontent is still running high. Most citizens believe that our healthcare system needs a radical change.

In the field of education, additional funds of BGN 120 m. were voted to provide schools with computer equipment and Internet access. The aims that must be achieved with this additional financing are promising; there is however no precise information on the number of teachers trained to use computers and any training needs assessment.

A strategy for the management of the existing enormous budget surplus is conspicuously absent. The National Budget Act for 2004 stipulated a budget deficit of 0.7 per cent for the year. Later the government announced that it aims to achieve a consolidated budget in 2004. The end result was a surplus of BGN 659.7 m. which occurred despite the generous spending at the end of the year.

There are also signs that in 2005 as well, no opportunities will be sought to weaken the role of the state in the re-allocation of funds, and no new approach will be applied in trying to achieve higher economic growth.

Because of a conflict of opinion between the government and IMF in late 2004, no agreement was reached on the future aspects of fiscal policy. After all, minimum wage was raised to BGN 150 and the capital of the state company "Public Investment Projects" EAD became BGN 260 m. The government is still faced with the challenge of proving that it will spend these funds expediently instead of pursuing only short-term objectives.

Foreign and domestic debt

General government debt. At the end of February, the total amount of government and government-guaranteed debt was EUR 7 265.6 m., which, when recalculated using the BNB exchange rate of 28 February 2005, runs at BGN 14 210 m. This is a considerable decrease in comparison to end-2004 due to the pre-payment of Brady bonds in January 2005 totaling BGN 1 734 m. (principal and interest).

domestic debt is in the amount of EUR 1 393.2 m. (BGN 2 724.9 m.). domestic debt has decreased by EUR 92.4 m. as compared to the end of the previous month. This is mainly due to repayments made in the course of the month. In the structure of domestic debt as of 28 February 2005, the GS debt for funding the budget deficit was EUR 1 166.5 m. and GS issued to fund the structural reform - EUR 226.8 m

Debt/GDP. At the same time, the debt/GDP ratio is 34.4 per cent, registering a decrease of 0.4 percentage points as compared to end-January 2005. In the debt structure, the relative share of domestic debt is 19.2 per cent while the share of foreign debt is 80.8 per cent.

The downward trend for the relative share of foreign debt in the total debt amount continues, while domestic debt in absolute terms registered a slight increase.

Table 7. Amount of government and government-guaranteed debt (EUR million)

Structure	As of 31 December 2004	2005	
		31.01.	28.02.
Domestic debt	1 370.6	1 380.6	1 393.2
Foreign debt	6 584.6	5 977.6	5 872.6
Total debt	7 955.2	7 358.2	7 265.8
Total debt (GDP %)	40.9	34.8	34.4
Domestic debt (GDP %)	7.0	6.5	6.6
Foreign debt (GDP %)	33.8	28.3	27.8

Source: MoF data, Government Debt monthly bulletins

As a result of payments made during the first two months of the year, certain changes were registered in the currency structure of debt at end-February 2005: debt in EUR - 43.2 per cent, debt in US dollars - 27.7 per cent, debt in other currencies - 14.7 per cent, debt in BGN -14.4 per cent.

This means that the trend towards decreasing foreign debt, esp. US dollars debt, is persisting. Foreign debt management was one of the most widely acclaimed actions of the current government, with the impressive rate of 27.8 per cent relative share of foreign debt in GDP.

Foreign debt. As of end-February, foreign debt was in the amount of EUR 5 872.6 m. while it was EUR 6 584.6 m. at end-2004. Government debt is EUR 5 423.3 m., government-guaranteed debt - EUR 449.3 m.

According to MoF figures, since the beginning of the year GS worth BGN 115 m. were issued, of which as little as BGN 0.6 m. were sold to individuals. These figures show that there is still much to be desired to activate individual savings in GS.

New financing. From the beginning of the year, **new** loans in the amount of BGN 29.1 m. were received, against total foreign debt payments of BGN 1 885.6 m. For this period the largest amount is that of World Bank loans - BGN 9.6 m., and the EIB – BGN 3.9 m. Net foreign financing as of 31 October, 2004 is a negative value and amounts to (minus) BGN 1 610.9 m.

Development in the legal framework

Major changes in tax laws were made at the end of 2004 and were commented on in our previous edition.

Implementation Regulations on the Excise Act. Some of the more important changes in legislation since the beginning of the year are related to the adoption of the Implementing Regulations on the Excise Act. New aspects include:

- changed methodology for calculating the excise duty for spirits, cigarettes, and tobacco products;
- change in the procedure for sales of excise labels;
- changes in the statement-declaration for additional payment of excise duty on tobacco products in the event of changed excise rates;
- statement-declaration to apply for excise labels.

the Corporate Income Tax Act approved (1) samples for the annual tax return for final tax payable by budget-financed enterprises, (2) form of the tax returns for final tax withheld at source and (3) form for a declaration for shares and interest held in foreign companies, affiliates and place of business abroad, as well as immovable property

Other important changes were introduced in Ordinance 4 of 1999 on the terms and procedures for sales accounting at trading outlets. The mandatory use of fiscal devices is waved for sales of chattels related to liturgical activity, rituals and ceremonies of the Bulgarian Orthodox Church, and by entities registered under the Religious Denominations Act.

At the same time, “Bulgarian Postal Services” EAD, “National Electric company” AD, electricity distribution companies dealing in electricity distribution as per the Energy and Energy Efficiency Act, and BTC EAD will be obliged for sales where payments are not made via wire transfers to bring their activity in line with the requirements of that Ordinance no later than 31 December 2005.

This year kicked off very dynamically in the area of social policy and was marked by strong public discontent with healthcare reforms. Active measures to promote employment continue to be the focus of social policy; their implementation is increasingly associated with the business community's active participation. All major actors in social policy (the state, the business community, local government, non-governmental organizations) are involved in seeking and experimenting with flexible and innovative approaches to addressing the problems of unemployment and poverty, with special emphasis on overcoming the workforce educational and training deficit. Special attention is given to youth unemployment and people with disabilities. The time is ripe for continuing reforms in social security in order to guarantee the financial stability of the system and reduce the social security insurance burden. The stagnated healthcare reform continues to be a legitimate reason for concern and continues its harmful effects on the nation's health; the reform outlook becomes more uncertain by the day. The analysis of developments in the social security and healthcare field is very closely linked with the approaching general elections.

Employment and unemployment. Labor market policy

Unemployment. During the first months of 2005, the rate of unemployment (as a relative share of the economically active population) continues at around 13 per cent, which means levels close to the quarterly average values of last year. At the same time this indicator is much below the values for the same months of 2004 and 2003. A positive fact is the continuously shrinking number of unemployed young people under the age of 29 and of unemployed individuals over 50, i.e. the two groups most at risk on the Bulgarian labor market. On the other hand, however, the number of new jobs has been declining since December 2004, or in other words – if this trend persists, opportunities to cut the unemployment rate further are diminishing. Consequently, the number of new employees as compared to the preceding month and the preceding year is also going down.

National Action Plan on Employment. The general framework of development of the labor market in Bulgaria in 2005 is outlined in the National Action Plan on Employment. It contains projections for an average annual unemployment rate of 12.5 per cent and stipulates BGN 200 m earmarked in the national budget for active labor market measures. This year's plan provides no different or innovative measures to reduce unemployment apart from the subsidized employment programs implemented in the past two years and targeted at specific "at-risk" groups on the labor market – long-term unemployed, people over 50 and of pre-retirement age, women, and young people. For each group the Ministry of Labor and Social Policy has developed and is implementing specialized programs - their number in 2005 will reach almost 100. This is, beyond doubt, a positive development.

In the meantime, however, the capacity of these programs to mechanically reduce unemployment is beginning to dwindle. The continuous implementation of similar programs - and on similar scale - is not a solution to the labor market problems. From now on special emphasis should be placed on vocational training and internship opportunities through subsidized employment programs for the purpose of equipping unemployed people with basic literacy, vocational skills and working habits. Only then will this policy have long-term positive effects on the employment and income situation in Bulgaria. Otherwise subsidized employment should be limited to the necessary minimum and cover only those groups of unemployed people of active age who have no other chance to find work.

The partnership already established between government institutions, municipalities, regional authorities and the business community in the implementation of subsidized employment programs must continue in the future. It is desirable to give priority to the participation of the business community and to support its requests for more investment in training and qualification, particularly given the workforce shortages in tourism, food & beverage and sewing industry, construction.

Vocational training. A positive sign for a shift in the mindset and practices of all institutions involved in vocational training and qualification of the workforce is the adoption earlier this year of the *National Strategy for Continuous Vocational Training 2005-2010* . The program will be implemented with financial resources from the state budget and EU pre-accession funds. Meanwhile tax relief and incentive measures are considered for employers setting up on-the-job training programs and encouraging their employees' vocational training. As it is, as few as 28 per cent of companies are taking steps to encourage the professional and carrier development of their staff. The Strategy is a policy paper intended to motivate both employers and employees to become actively involved in continuous training. In order for such an initiative to be successful, however, a number of training programs must be updated, whenever possible - by using electronic distance learning methods, and the quality of training provided should be considerably improved.

Expectations. In the months before the end of the year, positive developments are to be expected on the labor market in view of the planned adoption of amendments and supplements to the Employment Promotion Act and some pieces of implementing legislation aiming to encourage the personal initiative and responsibility of unemployed individuals to find work.

Incomes and standard of living

The issues of income levels and standard of living are a particularly sensitive topic because of the low income baseline levels immediately before Bulgaria's accession to the EU and, above all, during the pre-election period. In this light, serious public attention has been focused on this issue since the first days of this year, with debate often yielding to populist temptations.

Consumer Expectations. The start of 2005 marked a very slight increase of pessimism in consumers' assessment and expectations; this is supported by data from regular consumer surveys carried out by the NSI (January 2005) as compared to opinions registered three months earlier. Inasmuch as this data is the only source of information for analysis and outlook in the area of incomes and standard of living at the moment, a rather unfavorable situation in respect of unemployment and households' saving capacity is outlined several months before year's end. At the same time, there are no expectations for major negative developments in the economic situation and consumer price fluctuations.

Household Debt. Analysis of the income dynamics requires a more detailed review of the state of indebtedness of households to banks. This is a relatively new trend in view of the credit boom, particularly in 2004. According to a BNB study, households with higher per-member income become indebted faster. The debt of households to banks is approximately BGN 4.7 b. For the period December 2003 - November 2004 it has grown by BGN 1.8 b. At the same time, the financial assets of households have registered an increase of BGN 2.4 b - in other words, households continue to be a net creditor to the economy. The growth in 2004 of consumer loans at an annual base of 74.8 per cent indirectly points at higher household incomes and expectations for stable and growing incomes in the future.

"Pockets of Poverty". While, at one end of the scale, Bulgarian households in increasing numbers are able to benefit from consumer and mortgage loans, on the other end, poverty in Bulgaria is turning into a lasting trend for certain regions and municipalities. This fact requires consistent and aggressive government policy to overcome poverty and social exclusion in the so called "pockets of poverty".

For the first time since the beginning of the transition period, in 2005 Bulgaria is equipped with a "Poverty Map", or, to put it in other words - with information on the poverty indicators' breakdown by regions and municipalities (level and depth of poverty). It will help reveal and analyze the cause of regional disparities and draw conclusions and local policy recommendations. "The Poverty Map" shows that at the level of "regions" (oblasti), the disparities in respect of the relative share of poor people as compared to the total population are not as big as they are at the "municipalities" level. The document outlines several "pockets of poverty" where more than one-fourth of the population is classified as poor. These are the regions of Silistra, Targovishte and Kardzhali, as well as some border municipalities in the Blagoevgrad and Smolyan regions. The distribution of municipalities according to the level of poverty shows that in 30 Bulgarian municipalities more than one-fourth, and in 13 municipalities 9 more than one-third of the population lives below the poverty line. With the total number of municipalities in Bulgaria being 264, this means a little over 16 per cent of "poor" municipalities. 5.1 per cent of the Bulgarian population lives in these municipalities.

Characteristics of poverty. Identifying these most severely affected municipalities is an important first step, which - apart from quantitative information - also outlines their key characteristics and problems. These are as follows:

- weakly developed and poorly maintained infrastructure;
- underdeveloped industry and services sector;
- the municipalities are located close to one another, mostly in rural and mountainous regions;
- high unemployment and low level of education of the local population.

"Overcoming Poverty" Program. Against this background and in the form of a pilot project, the Ministry of Labor and Social Policy developed and launched a program entitled "Overcoming poverty in the 13 poorest municipalities". It deserves attention and analysis because this is the first attempt to apply a regional approach to tackle such a complex problem as poverty; moreover, its underlying concept interprets poverty not just as the absence of income but as limited opportunities for access to education, healthcare and other social rights. The program budget for 2005 is BGN 2 million. It envisages engaging the unemployed in training for basic literacy and vocational skills, providing subsidized employment and support for self-employment. Such programs are an initiative to encourage employment and overcome poverty, but they should not be relied on for lasting and large-scale effects. The chance of poorer municipalities lies with possible investor interest in their hitherto unexploited potential to develop tourism, organic farming, food&beverage industry or manufacturing units as part of a larger production chain. For this to happen, however, the construction of modern infrastructure is an indispensable minimum condition.

Social partnership and industrial relationships

The fact that 2005 is an election year explains the increasingly politicized tone in relations between employers and trade unions in the first months of this year. Therefore it seems as though the latter's movements and activity are to a lesser degree aimed at finding solutions to labor relations and social development and more focused on holding meetings with political forces and appeals for certain social and economic requests to be met against promises for support at the coming elections.

The Employers' Association, the Bulgarian International Business Association, CITUB and "Podkrepa" trade union share the same goal - economic growth, improved competitiveness, innovation development. Employers and trade unions were also united around the idea that there is a pressing need for investment in the re-qualification of workers and improving the workplace conditions. Employers declared their readiness to serve as guarantor of higher incomes and social protection, while the trade unions vouched to stand for higher productivity and quality of labor. This proximity of positions is a prerequisite for stability and predictability in industrial relations; it should be borne in mind, however, that for now it has only been agreed and declared at the national level. It still remains to be seen whether this is possible to achieve at lower levels of the employers - trade unions dialogue. It is of common interest to both parties to join efforts and thus yield more power of impact when dealing with political decision-makers on issues such as infrastructure, education and healthcare.

As in past periods, there have been episodic outbreaks of social tension. Traditionally they are related to the pending privatization and/or restructuring (CHPPs) and still strongly unionized industries and sectors (teachers). Practical experience shows that this approach by trade unions is not radicalized and usually results in reaching mutually acceptable solutions.

Social security

Undeclared employment. Business regulations introduced two years ago on the mandatory registration of labor contracts at NSSI and the minimum social insurance thresholds according to type of economic activity and groups of professions turned out to be positive but not entirely efficient measures to fight undeclared employment. This is the conclusion after analyzing the results of a nationally representative study carried out in early March 2005 by the National Centre for Public Opinion Studies and sponsored by MLSP. The purpose of the study was to outline the groups that most frequently suffer at the hands of employers in respect of their labor and social security insurance rights, and supply an answer to the question of whether workers are inclined to stand up for their violated right of social security insurance. Only 58 per cent of respondents claim they are insured for the actual amount of wages while 13 per cent work without getting social security insurance from their employers. The above figures show beyond doubt that the state must develop a new package of more efficient measures to encourage employers to pay social security contributions on the actual amount of their workers' wages.

Social security burden. The key reason for business managers to refuse to pay social security contributions to the NSSI on the basis of actually paid wages is the relatively high social security burden - 42.5 per cent in Bulgaria, among the highest in Europe. It increases labor costs for businesses and does not encourage employers to create new jobs, increase wages or pay social security contributions corresponding to actual wages. On the other hand, the relatively large deficit of the "Pensions" Fund in State Social Security that is being covered by government subsidy disencourages politicians to take active measures to considerably reduce the social security burden.

The high social security burden is among the major barriers to the normal functioning and development both of Bulgarian companies and foreign business agents in the country which is extremely important for increasing the general competitiveness of the Bulgarian economy and the successful integration of the country in European and global economic structures. That is why, in the course of the past six months, this problem was put on the agenda by representatives of both employers', trade union and non-governmental organizations, and by representatives of various political parties, which shows that political will for legislative initiatives in this direction is in place. Even more, reducing the social security burden is a goal underlying all social and economic programs of political parties that are getting ready to govern Bulgaria for the next four years.

Social security reform proposed by CITUB. The latest *proposal* for social security reform was presented by trade unions at a discussion forum seeking a more fair distribution of the total tax and social security burden held at the end of March 2005. The issues of the significant income stratification of society which stimulates social polarization and poverty among employed people, the employers' unwillingness to declare the actual wages of workers, the "grey" labor market and the "trap" of poverty and long-term unemployment, caused the CITUB to develop a mechanism to reduce the total tax/social security burden. CITUB's proposal involves several basic elements:

- introducing differentiated rates for mandatory personal social security contributions depending on the amount of income and a nine-step income scale with progressive increase of due social security insurance contributions;
- overcoming the existing discrimination in social security relations of individuals working under labor and civil service legal relationships; according to the proposal, civil servants should start paying their share of social security contributions at their own expense;
- making employees with gross wages close to the minimum wage exempt from social security contributions; due contributions to be paid by the employer; and
- engaging the state as an universal insurer along with the employee and the employer (distribution of social insurance burden between employers, employees and the state in a 65:25:10 ratio).

As a result of this new social security mechanism, the CITUB is expecting that actual monthly wages of employed people will increased with priority to low-income groups, the rate of concealment of actual incomes would go down, the social protection of workers will be improved, there will be higher motivation to seek more qualified and productive labor, the income stratification will be reined in and, last but not least, poverty levels and the number of the so called "working poor" will be reduced.

The trade unions' idea to include the state as an insurer alongside employers and insured individuals and the proposal that civil servants should also pay their share in the social security contributions are shared by the Center for Economic Development.. Also possible are other options to distribute the social security burden between the state, employers and workers as a 40:40:20 ratio (NSSI proposal) and 40:30:30 (CED proposal). The most appropriate option should be approved after detailed estimates of the financial, economic and social effects of each option are prepared and only following in-depth expert and political discussions involving all stakeholders.

Introducing a progressive social security insurance scale is assessed by NSSI, MLSP, employers and CED as an unacceptable replacement of the principles of the existing social security model in Bulgaria, which is also associated with higher administration costs for social institutions and small and medium-sized enterprises, which are not yet prepared to face such a challenge.

CED opinion. According to CED, the enormous social security burden is among the major barriers to attracting foreign investment, increasing the competitiveness of Bulgarian businesses and the economy as a whole, and also to creating more and better new jobs and achieving more active social cohesion. Therefore overcoming the problem of the long-term financial sustainability of the pension system should be sought by exploring the option for general decrease of the social insurance burden and the establishment of a reserve fund financed from domestic and external sources. A similar idea was recently "marketed" by the ruling majority as it proposed financing the fund from the budget surplus, privatization revenues and license fees. Apart from financial support to the pension system, such a fund is expected to provide a retirement opportunity for people who have reached retirement age but are long term unemployed. The ruling majority is also considering the option to continue the practice for people of retirement age but without insurance rights, to be able to "purchase" social insurance time by paying contributions for the period of their university education.

Unfavorable demographic trends are present not only in Bulgaria, but also in most European countries. They, too, are seeking a solution to this problem by taking actions to limit early retirement, prolong the working life, diminishing the public debt and building reserve public pension funds. According to CED, the idea for establishing a reserve fund under strict public control to provide financial support to our pension system deserves the attention of all political forces and the social partners for the purpose of achieving bipartisan consensus on improving the social security system. Reducing the social security burden must be a priority in the social and economic program of the next government.

Changes to the Labor Code. Changes to the Labor Code adopted by the Parliament in mid-March this year are a step forward in the direction of improving the flexibility of the labor market. Amendments to the Labor Code allow workers and employees to work over 40 hours per week, provided they have given their consent, and are granted the legally regulated time for rest between working days and working weeks. The repealed Labor Code used to limit overtime work to 8 hours per week, while the European directive puts no restriction in this aspect.

Another barrier to the success of the tax/social security reform is the continuing absence of the Tax Insurance Procedure Code that is expected to unite tax and social insurance procedures so that the National Revenue Agency could become operational in 2006. Streamlining the public revenue collection is expected to increase the collection rate for tax and social insurance payments, which could provide an opportunity to reduce the total tax/social security burden for employers and workers; however, for the time being there are no indications that will be put to practice before the beginning of next year.

Transposition on European directives. An important challenge to Bulgaria in the area of social security prior to the country's EU accession is also the need to transpose the provisions of three European directives into the national social security legislation. These are Directive 2003/41/EC on the Activities and Supervision of Institutions for Occupational Retirement Provision, Directive 98/49/EC on Safeguarding the Supplementary Pension Rights of Employed and Self-Employed Persons Moving within the Community and Directive 86/378/EC on Equal Treatment in Occupational Social Security Schemes. A positive step towards coordinating the Bulgarian social security scheme with these in EU Member States is the Agreement for Export of Social Insurance Payments with the Netherlands signed by the Minister of Social Policy in February. Signing agreements on social security, that generally accompany the exchange of workers is an effective policy for increasing the workforce mobility, providing better protection to migrants and guaranteeing more efficient measures to fight illegal migration. In addition, these agreements are a successful measure to satisfy the concerns of EU Member States about possible pressure on their labor markets after the accession to the European Union of South-East European countries.

Challenges to Supplementary Pension Insurance

General trends. The trend for sustainable development in supplementary pension insurance has continued. In late 2004, according to preliminary data supplied by the Bulgarian Association of Supplementary Pension Insurance Companies (BASPIC) the accumulated assets of supplementary pension insurance funds exceed BGN 787 m which means a 53 per cent growth as compared to 2003. The largest market share belongs to voluntary funds with net pension assets of 41 per cent. Next in the rating is the share of universal pension funds – 33 per cent, and the bottom position belongs to the share of occupational pension funds – 26 per cent. The trend of increase in the relative share of UPF assets in total pension fund assets at the expense of the relative share of VPF assets that persisted over the past two years, has continued. This is explained by, on the one hand, the continuing increase in the number of individuals insured in UPF, and on the other, on the increase of the insurance contribution in UPF (from 2 per cent to 3 per cent since the beginning of 2004). At the end of 2004 insured individuals in pension funds now exceed 2 715 thousand people, which means an 18 per cent growth as compared to 2003.

Table 8. Development of Supplementary Pension Insurance in 2004

Accumulated assets in pension funds as of the end of 2004	BGN 787 m
Growth as compared to 2003	53%
Accumulated assets in pension funds as of end 2004	BGN 2715 thousand
Growth as compared to 2003	18%

Source: Preliminary data by BASPIC

2004 Assessment. The past 2004 is assessed as very successful for the development of the pension services market in Bulgaria. The positive evaluation is based on:

- considerable increase in the number of insured individuals and pension funds' assets;
- successful alignment of the activity of pension companies according to the requirements of the Social Security Code;
- successful migration to daily asset assessment of funds and accounting reports;
- better quality service to insured individuals;
- successful investment activity of pension companies; they managed to achieve good profit rates when compared to the interest rate for BGN deposits and the inflation levels; as well as
- the increased insurance culture of citizens.

BASPIC Outlook. According to BASPIC expectations, accumulated resources in pension funds will exceed BGN 4 b and the number of insured individuals will reach almost 3 million people by 2010. Data on the structure of investment of pension companies show that assets in the national pension system are still not used actively enough to increase the competitiveness of the Bulgarian business and economy as a whole, which is extremely important in the years to leading to Bulgaria's EU accession. Pension assets are mostly invested in GS, bank deposits, mortgage bonds and securities registered for trading on regulated markets. For the projected increase in pension assets by 2010 to come true, capital market institutions with the participation of employers' organizations need to offer new investment instruments that are more attractive to businesses and institutional investors, among them pension companies. The development of the pension market sets new requirements for changes in the way supplementary pension insurance functions under the "capital-funded" scheme. Part of the challenges faced by the pension sector in 2005 are related to strengthening the mechanisms for expanding the scope of the system through tax breaks, improving the relative proportion of the "capital-funded" scheme as compared to the "pay-as-you-go" system and establishing more favorable terms for effective investment policy by pension companies.

Healthcare Reform

Need for reforms. Over the past months both representatives of employers' organizations, private health funds and non-governmental organizations publicly voiced their opinion on the necessary direction for development of the Bulgarian healthcare model. The enormous public discontent with the functioning of this system requires reaching a bipartisan consensus on the development of the healthcare model in Bulgaria within the shortest possible terms, which is hardly possible in view of the pending general elections and the absence of political will.

BIBA Report. According to the annual edition of "Bulgaria: Beyond the Facts" for 2004[25] healthcare is ranked first in the list of major social problems in Bulgaria. The delay in introducing urgent reforms in this sector can increase citizens' withdrawal from political activity and result in low turnout at the election, which will question the legitimacy of the elected Parliament, "Bulgaria: Beyond the Facts" warns. In its annual report "The Bulgarian Business on the Way to the EU", BIBA also insists on a radical change in healthcare. BIBA's key recommendations in this area are related to stepping up controls on the labor medicine offices, reducing the number of hospitals in order to improve the quality of the services, and transfer to private sector medical activities that do not involve hospitalization. In addition, BIBA recommends encouraging the creation of a sufficient number of private health insurance funds that would accumulate the financial resources of insured individuals and provide various health products depending on the health services demand.

Proposals of health insurance funds. Private health insurance funds, on the other hand, see the major problems faced by the system of compulsory health insurance along the following lines: the presence of legislative inconclusiveness, financial instability, unprofitableness of healthcare structures, poor organization of healthcare service to patients, underestimating the problems of groups of population at high risk and, last but not least, the inability for control and quality management of healthcare services. The Association of Licensed Companies for Voluntary Health Insurance continues to insist that part of the health insurance contributions should be channeled to funds

[25] "Bulgaria: Beyond the Facts" is the only monthly publication for risk analysis in Bulgaria. It is the result of the joint efforts of UNDP, USAID and BBSS Gallup International. Data is collected through monthly nationally representative opinion polls carried out by BBSS Gallup International and official statistical sources.

for supplementary mandatory health insurance similarly to the universal pension funds in the pensions system. The principal proposals by private health funds for improving the healthcare system are towards the demonopolization of the health insurance; introducing higher tax breaks to encourage voluntary health insurance; setting up a smaller package of guaranteed health services as part of mandatory health insurance in order to provide room for development of supplementary health insurance; successful privatization of healthcare establishments and ensuring the equality of healthcare facilities, regardless of the type of ownership.

Most of the above proposals to continue healthcare reform in Bulgaria are reasonable but the lack of political will in the ruling majority and the forthcoming general elections leave no false hopes that the necessary structural changes in the sector will be adopted by the end of 2005. Unlike pension reform whose positive outcomes we are witnessing today, lack of a comprehensive vision for the development of the healthcare model in Bulgaria explains why changes are applied in a manner that is chaotic, uncoordinated, unsystematic, and therefore leading to strong public discontent.

Consensus Seeking. The healthcare system alongside the pension and educational system need a public, bipartisan consensus to be further streamlined because a possible undesirable direction of development results in lasting negative consequences for the entire society. Seeking such consensus, the Open Society Institute organized a discussion entitled "The Future of Health Reform: Is Political Consensus Possible", at which two reports were presented and discussed – a "left" and "right" outlook on the development of health reform in Bulgaria.

The fact that both independent expert reports indicate the need to encourage the development of voluntary health funds, as well as the fact that this idea gets the support of all political groups represented in Parliament, NHIF and professional organizations, shows that bipartisan political consensus in this area is possible. In addition, all political forces believe that more should be invested in the healthcare system. The issue of whether these additional funds should be generated by increasing the health insurance contribution, setting aside a larger percentage share of GDP for healthcare, or carry out an adequate reform in healthcare financing, is still debatable. Introducing unified reporting standards for health information and an integrated information system in healthcare are, as a whole, key factors for implementing efficient internal controls, which will allow a more fair allocation of financial resources within the system.

CED opinion. According to CED, the healthcare model in Bulgaria must develop in the direction of:

- striking a balance between state-financed and private sector in health care, with the latter given precedence;
- introducing an integrated information system on control and monitoring in the sector;
- promoting the development of voluntary health care insurance;
- establishing mechanisms for effective competition in the health sector and efficient protection of patients' rights;
- eliminating the NHIF monopoly;
- continuing the reform in the hospital sector;
- upgrading the mechanism of negotiating the National Framework Agreements and
- establishing adequate administrative capacity in the sector so that it would be able to face challenges expected as a result of the country's EU accession.

Table 9. Healthcare development models.

"Left-leaning" healthcare development model: basic steps towards change	"Right-leaning" healthcare development model: basic steps towards change
• step-by-step privatization of healthcare establishments while preserving the status of state-owned and municipal establishments providing equal access to all health services and goods for all categories of individuals; • abolish the "commercial company" status for University hospitals, specialized national centers and dispensaries; • introduce a minimum threshold for insured financial resources in healthcare of 5.0 per cent percent of GDP in 2006 year reaching 5.9 per cent percent of GDP in 2009; • the health contribution of 4 per cent payable by the employer to continue to be paid to the NSSI, while the citizens' personal 2 per cent contribution to be transferred to a licensed health insurance fund; • a three-pillar model of health insurance (mandatory health insurance of complete solidarity, mandatory supplementary health insurance of partial solidarity and voluntary health insurance of limited solidarity); • eliminate the NHIF monopoly; • create incentives for voluntary health insurance under preferential terms for the employer and citizen; • set up dedicated state fund to cover the health care costs for socially disadvantaged individuals overusing services included in the general healthcare package.	• privatization of healthcare establishments that are currently registered as commercial companies, with continuing state support to establishments specified under Art. 5, Para. 1 of the Act on Health Care Establishments; • eliminate the NFA and focus on individual contracts with healthcare establishments; • keep the 6 per cent mandatory health insurance contribution, against which the state will guarantee the minimum health package; • demonopolize mandatory health insurance by closing down HQ NHIF and granting autonomy to RHIFs and demonopolization of professional organizations; • stimulate private investment in the health sector through tax and administrative preferences; • each healthcare establishment granted the right to define by itself the price for providing healthcare packages; • each health insurance fund offers its own healthcare packages including the minimum package which is compulsory; • state control on the healthcare sector: the MoH on healthcare establishments regarding their madical activity, and the FSC on RHIF and voluntary funds regarding financial activity.

The key issues in the sphere of environmental policy during the first quarter of 2005 are related to climate change, regulating genetically modified organisms, sustainable management of natural resources, and biodiversity conservation.

Bulgarian participation in the Kyoto Protocol mechanisms

After 16 February 2005 when the Kioto Protocol formally entered into force, Bulgaria's participation in international emissions trade will also be possible at the government level. According to preliminary estimates, for the period 2005-2012 the country is assigned 250 million tons of free emissions (greenhouse gases from industrial installations "saved" as compared to agreed emission reduction units of 1990 baseline values). Bulgaria participates in the emissions trade via two Kyoto Protocol mechanisms – international emissions trading as a mechanism for the purchase and sale of greenhouse gases emissions between countries that are Kyoto Protocol signatories and Joint Implementation (JI - emissions trading where companies under their own initiative enter into contracts with government-accredited agencies). The country participates in the mechanism by trading three of the gases mentioned in the protocol - carbon dioxide, methane, and nitric oxide.

Bulgarian companies now have successful experience in the Joint Implementation mechanism [26]. Currently nine Bulgarian companies have emission trading contracts based on successful JI projects with agencies in European countries. Bulgaria has signed Memoranda with the governments of the Netherlands, Austria, Denmark, Switzerland, and the World Bank's Prototype Carbon Fund. Currently procedures are being prepared to apply the Green Investment Scheme, with Bulgaria expected to sign the first deal for emissions sale at the official state level. This will allow proceeds from the sale of emissions to be linked to investments in environment protection.

GMO risk prevention

On 15 March the National Assembly adopted **the Genetically Modified Organisms Act.** The bill was submitted by the Council of Ministers, and it is aligned with EU requirements specified in Directive 90/219 on the contained use of genetically modified micro-organisms and Directive 2001/18 on the deliberate release into the environment of genetically modified organisms. The Genetically Modified Organisms Act was voted and adopted by the National Assembly following drawn-out debate on its scope and content on the backdrop of public opinion that is divided on the regulatory mechanisms it introduces[27].

[26] The first contracts of Bulgarian companies under the "Joint Implementation" mechanism are described in the Bulgarian Economy, October 2004 CED, 2004.

[27] The discussion is described in detail in the report by the Center for Economic Development entitled The Bulgarian Economy,, July 2004.

[28] The National environmental network includes protected areas and territories where specific measures are implemented to protect and rehabilitate the biological, geological, and landscape diversity.

The law requires that companies trading in GMO provide background information on genetically modified products and the way they interact with the environment to the competent authority - the Minister of Agriculture and Forestry. Companies are obliged to describe the locations where GMOs will be used and to certify, using data from scientific and laboratory research, GMO's impact on people and the environment, the method of monitoring, and the control and treatment of waste after the use of GMO seeds. The preliminary risk assessment is compulsory if the product is to be placed on the market.

The dossiers prepared by companies should be in both Bulgarian and English and can be submitted electronically in an application form. After verifying data, a specially appointed expert committee will prepare a statement based on which the Minister of Agriculture and Forestry will issue the necessary permit.

The law introduces severe sanctions for the growing of blacklisted genetically modified organisms or genetically modified organisms in territories of the national environmental network[28] or in surrounding territories up to 30km. Animal species and agricultural plant varieties of national significance: tobacco, grapes, cotton, oil-yielding rose, wheat, and all vegetables and fruit, cannot be subjected of genetic modification. The list can be further expanded by the Minister of Agriculture and Forestry after consultations with the MOEW. The pecuniary sanction for the illegal growing, placement on the market, and export of genetically modified organisms and products is one million BGN. Placing GM seeds on the Bulgarian market is only permitted for the purpose of testing but not for mass use.

The law provides for GMO-containing products placed on the market to comply with certain requirements. All foodstuffs containing genetically modified ingredients must obligatorily have labels notifying the presence of GMOs before they are placed on the market. Another obligation is to announce the name and address of the entity responsible for the release of GMO - producer, importer, or distributor.

A Register of permits to place GMOs on the market will be created and kept in electronic form by the Ministry of Agriculture and Forestry, and consumers must be clearly informed how to access the Register and information it contains. The sanction for merchants placing on the market products containing plant varieties banned in the European Union or violating the requirements for labeling of foodstuffs containing GMO is in the amount from BGN 200 000 to 500 000.

The EU legislative framework concerning GMO that has been in place since the early 90s is among the strictest in the world. It requires a high level of scientific assessment and testing and at the same time protects the consumers' right to make their own choice. Its goals, to protect human health and the environment and to ensure the free movement of goods within the EU, are the underlying principles of Directive 2001/18/EC on the step-by-step introduction of GMOs. The Directive contains the so-called national safeguard clause. According to this provision any Member State has the right to impose a temporary restriction or ban on the use and/or sale in its territory of a product that has already been approved, if it has good reason to believe that it presents a threat to human health or the environment. Until now, this clause was invoked by Austria, France, Germany, Luxembourg, Greece, and the United Kingdom. In January 2005 Hungary invoked this clause in order to ban on its territory the growing of maize of the MON 810 type.

Regarding responsibility and companies' obligations, the Bulgarian law took an approach similar to the existing EU legal setting. Each product entering the EU market, is subject to testing of GMO content and labeling. Because of the "free movement of goods" principle, this requirement applies to all EU countries. According to the procedure, the company must file an application for written approval to the respective national agency attaching the complete risk and environment impact assessment. The Agency then establishes an opinion, and if it is negative the company has the right to apply for the same product before the agency of another Member State. In case of a favorable decision, after its assessment the respective Member State informs remaining EU Member States and the Commission, which in turn review the case and the supporting documentation. Prior to the experimental release of GMOs, the company is obliged to apply to the country on whose territory the release will take place. The risk assessment when filing an application for approval is valid for all types of product use, and the product is defined as "consisting of GMO" or "containing GMO".

The labeling and traceability requirements for GMOs are specified in Regulations 1892/2003 and 1830/2003 of the EU. The obligation to indicate on the label the use of GMOs does not apply to milk, meat, or eggs from animals fed with GMO feeds. The clear labeling rules allow farmers and other users to decide for themselves whether to purchase a given product. The producers of GMO seeds however are obliged to provide buyers with detailed product information. This allows for the precise identification and tracing of seeds. The same requirements apply to farmers who are obliged to inform buyers on utilized GMO seeds.

Presently there is no official information in Bulgaria on genetically modified plant varieties placed on the market. There is also no conclusive information on the capacity of institutions authorized by the legislator to exercise efficient controls on the implementation of the law. Bulgarian consumers' major concern is associated with the guarantees for the preparedness of existing scientific laboratories and their capacity to exercise efficient controls on companies using genetically modified seeds and feeds in their activity, as well as the compliance of GMO products with the legal requirements.

Water Management

Two new pieces of legislation were submitted to the National Assembly regulating public relations directly related the quality and terms of use of natural resources in Bulgaria.

The Bill on Water Management aims to align national legislation with the EU's Framework Directive on Water, to overcome the gap existing in Bulgarian legislation regarding the differentiated treatment of water as a national natural resource, and to use them in the process of service provision in the water supply sector.

The draft law introduces a public-private regime of water use. The economic regulation of activities related to the use, rehabilitation, and maintenance is based on the following four principles:

- ensuring equal access of all citizens to water for household purposes, treatment, and prophylaxis as a priority of state and municipal policy;
- complete return of cost for water services, including for water protection;
- ensuring a socially bearable price for the service of household water supply to the population, while at the same time encouraging the sparing use of water;
- encourage the use of surface water for irrigation, fishery, and electricity generation purposes, and contained use of underground waters exclusively for household purposes.

Compulsory economic analysis of water use is introduced for planning purposes. As a mechanism to check the cost of services in the water sector, it will be the base for defining, forecasting, and restoring the cost of water protection and for finding the most effective measures in national and local programs in respect of the cost/benefit.

Water use in the country (i.e. the services in the water sector that have significant impact on the condition of water) will be carried out on the basis of the economic analysis for each basin management area. The document will include a water use assessment for each branch of the water sector, water protection cost assessment, and estimates of investment needs. It is required to reflect with maximum precision the contribution of key users of water resources – industry, agriculture, and households, to the return of all cost in the sector.
For activities involving the use of water as a resource, the law introduces the following fees:

(1) for water-rent or concession fee;
(2) for use of water resources (applies to those holding permits for this activity);
(3) for water pollution depending on the quantity of polluting substances;
(4) fee for use of the water environment or removal of alluvial deposits in water.

The bill submitted by the Council of Ministers features an important aspect - it legally regulates delegating parts of governance functions currently exercised by the MoEW to regional water management bodies which are the four already functioning basin directorates.
While the Water Management Act introduces the general principles of the use and conservation of water as a national heritage and natural resource, the relations related to ownership over the systems and facilities for water use and to the services in the water sector are subject to additional regulation in special laws.

Management of natural resources

The Bill on Caves drafted by the Council of Ministers was submitted for discussion in the National Assembly on 7 February 2005. It aims to regulate the relationship between the state and legal entities and individuals in respect to the conservation, use, and management of caves as a national resource and natural heritage. The draft law introduces a classification of caves according to significance and provides for an option to allow production activity in caves falling under the "Without Particular Significance" category. The Minister of Environment and Water is the competent authority in awarding concessions, conducting procedures to select a concessionaire, and representing the state when signing concession contracts for caves. The law also allows for construction in caves for tourist, healthcare, production purposes, and for the purpose of protecting cultural monuments located in caves.

Biological diversity and the responsibilities of the state

The issue on the rights and responsibilities of the state in respect of the consumption of natural resources is particularly pressing in connection with two other draft laws that are currently being discussed at the National Assembly. The protection of the national biodiversity is the subject of the Protected Areas Act and Act on Amendment to the Biodiversity Act Both laws, upon proposal by the Council of Ministers, and are subject to amendments and supplements. The proposed amendments in the Protected Areas Act provoked serious public criticism as they were allegedly going to trigger mass construction on the territory of lands and forests in protected areas. The increased powers of the Minister of Environment and Water and the simplified decision-making procedures raised the most concern. This fact will create legal opportunities for plots in protected areas (which are currently as few as 5 per cent of the country's territory) to be taken out of the protected area for construction purposes. Taken as a whole, the opponents of these proposed amendments believe that such actions would result in the deteriorated management of national and natural parks[29] and will adversely impact Bulgaria's chances to participate in the European environmental network "Natura 2000".

[29] This applies to the greatest degree to the regions of the Vitosha Nature Park, Pirin Nature Park, Strandzha Nature Park, parts of Rila, Pirin, and protected areas along the Black Sea coast.

The banking system continues to dominate the financial sector and financial intermediation in our country. Loans remain the most dynamic balance sheet component. The new regulation by BNB (the Regulation) did not yield the anticipated result; on the contrary, it led to a lending explosion during the last weeks of March. This explosion distorts financial (banking) statistics for March and the first quarter of 2005 to such an extent that their financial analysis to a great degree is rendered useless. This becomes evident from the following analysis of the regulation. Under these circumstances, this review rather intentionally covers February and excludes March.

Number of banks. The banking system consists of 35 banks. The first group covers by definition the 10 largest banks by balance sheet figures. The second group comprises the remaining Bulgarian banks. The third group consists of branches of foreign banks in Bulgaria. The number of banks by groups is 10, 19 and 6, respectively

Broad money. Money in circulation continues to grow at a fast pace. For the first 10 weeks of 2005, money supply grew by BGN 20.4 b to reach BGN 21.15 b, i.e. 5.4 per cent growth, and for the last 12 months (February 2004 – February 2005) the growth exceeds 24 per cent.

Assets. At the end of February, the total assets of the banking system amount to BGN 25.1 b; there is a slight growth of 1 per cent versus January. For the period February 2004 – February 2005, this growth is 39.5 per cent. During January a slight decline of assets was observed that could be explained by the decrease of the deposit base of banks, mainly in Euro.

Deposits. Deposits from financial institutions continue to grow in February compared to January by 14.2 per cent. In turn, deposits from non-financial institutions and from other customers note a decline in February of 0.5 per cent.

Foreign exchange structure. The downward trend of deposits in foreign exchange, other than Euro, persists. At the same time, demand is highest for loans in BGN, followed by other currencies, and least is the demand for loans in Euro.

Lending. Gross loans grew by 2.15 per cent in February to reach BGN 14.5 b and in January they grew by 2.77 per cent. After accounting for the impairment in the form of provisions, growth is 2.1 per cent and 2.74 per cent, respectively.

Banks from the first group mark highest growth – 2.6 per cent. At the end of February, the share of loans to assets reached 55.69 per cent. For comparison, this share was 55.74 per cent at the end of January and 53.56 per cent at the end of December. It is worth noting that at the end of March gross loans reached BGN 16.7 b, i.e. only within March a credit growth was reported at a phenomenal 15 per cent. Taking into account that as of 8 April loans dropped by BGN 527 m, it becomes clear that most of March statistics are seriously distorted.

Loan structure. In March, the growth of housing and mortgage loans is highest percentagewise – 5.7 per cent, followed by the increase of consumer loans by 4 per cent.

Net profit. In February, net profit amounts to BGN 85.7 m, which represents a 38.35 per cent increase from January.

The New BNB Regulation

Substance of the Regulation. On 22 February 2005, The Management Board of the Bulgarian National Bank (BNB) adopted amendments to Ordinance No. 21 (the Regulation) on the required minimum reserves that banks should maintain with BNB. Through this amendment, BNB continues the its stabilization policy of credit growth to the private sector to a more moderate level that can be maintained in the mid-term without threatening the stability of the financial system.

The recent measure of the Central Bank contains the following major elements:

1. Banks with the most aggressive lending policy shall have to set apart additional required minimum reserves with BNB, representing an incremental "buffer" against potential occurrences of accumulated credit risk.
2. In order to fall within the scope of the regulation, commercial banks need to have met simultaneously two criteria:
   a) to have exceeded the *three month growth rate* set by the Central Bank of 6 per cent for the first quarter, 12 per cent for the first two quarters, 18 per cent for the first three quarters and 24 per cent for the whole year;
   b) the sum of loans made by them and risk-weighted off-balance sheet items, made equal to balance sheet assets, less equity, shall exceed 60 per cent of borrowed funds from entities other than banks and non-banking financial institutions.
3. A bank, which reports values higher than the above criteria, shall set aside additional required minimum reserves with BNB at the double amount of the absolute figure of the excess over the three month growth rate set in the regulation. Banks that do not violate the criteria remain outside the scope of the regulation.

The regulation allows banks that wish to exceed the limits of the three-month growth rate to do so, but in order to do so, they must "pay" for the additional risk by maintaining additional required reserves with BNB. The Bulgarian National Bank preserves the right to undertake additional measures aimed at balanced and sustainable growth of lending to the private sector.

This measure is of a temporary nature and will be effective until more moderate and stable growth rates of lending to the private sector are achieved.

The amendments to Ordinance No. 1 diminished also the number of currencies in which commercial banks can maintain the required minimum reserves. As of April 2005, required minimum reserves can be kept only in the national currency (BGN) or in the reserve currency (Euro).

Need for the regulation. This regulation was provoked by the fast rates of credit expansion registered in our country over the recent years. Credit growth in 2004 was about 50 per cent, as the previously enacted regulation did not have the desired effect. There exists an established opinion among experts and economists (and we agree) that the financial system stability would be considerably threatened if the current pace of credit expansion were preserved in the mid-term. This pace needs to be "normalized" to rates close to the one in developing countries where growth is in the range of 8-12 per cent. However, in view of the low starting point of loans in the banking system, we presume as normal in the medium term to have a slightly higher growth rate of lending of about 20-25 per cent per annum.

Effect of the regulation. The regulation was needed but would hardly have the effect desired by BNB. In our opinion, it will contribute significantly less to the reduction of credit growth than expected. Moreover, in its current form the regulation will not limit the credit expansion. The major reason lies in the numerous available methods to circumvent its requirements.

Circumvention of the regulation. First, item 2 requires that *both criteria are in place at the same time* for a bank to fall in the scope of the regulation. In order to have an effect, the regulation had to require only one of the two conditions. Now banks will be able to maintain high growth rates by violating the requirement for restricting growth within 6 per cent per quarter while at the same time meeting the second criterion.

Second, the regulation became effective on 1 April, 2005, i.e. *after* the date of its promulgation. This means that 31 March shall be assumed as the reference base for the growth. In this situation commercial banks had about 6 weeks at their disposal to manipulate their base to their desired level. This allowed them to "boost" their loans up to the "cut-off" date of growth.

Third, the regulation covers only banking institutions, but not *leasing* companies. This means that every bank may channel (or funnel or divert) most of its mid-term and long-term loans through their leasing units, thus circumventing the regulation. It is not coincidental that each large bank already has its own leasing arm. The infrastructure of these subsidiaries continues to expand. Under today's lending conditions, a bank may divert at least half of its loans through leasing. While staying within the permissible 24 per cent growth rate of bank loans, the additional credit expansion may add at least 25-30 per cent more through leasing, so that total credit expansion registers yet again 50 per cent growth.

Fourth, the regulation leaves "loopholes" for banks to borrow from their parent companies abroad at significantly lower interest rates and to continue their expansion unpunished.

Our conclusion is that with such "loopholes" allowing circumvention of the regulation, it will hardly have any significant effect.

Weaknesses of the regulation. In addition to the numerous ways to get around the regulation, it also has a number of weaknesses, each contributing to additional destabilization of the banking system or to lowering of inter-bank competition. The first major weakness is the "equal" treatment of all banks, irrespective of the amount of their assets and their capital adequacy. Such "equalization" in fact puts small banks in an extremely unequal position. Accounting for their relatively high operational costs and relatively small deposit base, they either have to aggressively expand their portfolios or they are doomed to operational losses. The latter will force them to "sell" themselves to the larger ones, thus undercutting competition in the banking sector. In our opinion, the regulation will not only have no controlling effect on the credit growth of the banking system, but will also give a extra-bonus to large banks – the opportunity for the big to devour the small. In addition, it was announced that before publishing the regulation, BNB has consulted with the "Big Nine" banks on how to draft (or craft or articulate) the regulation; there has been no coordination with the small banks. This is evidence of the protective stance of BNB with respect to large banks.

The second weakness of the regulation is the absence of certain limits by loan type in the credit portfolio. This means that credit risk can be concentrated in certain sectors, as is the case with real property. In a certain point in the future it may prove that wherever greatest banks' exposures, i.e. excessive lending, problems will arise there in respect to borrowers' solvency. Hence, problems with liquidity and destabilization of the banking system will arise.

The third weakness of the regulation is the absence of differentiation of the type of collateral (or lack thereof) in the coverage of loans in the portfolios. This allows individual banks to increase their loans through poorly collateralized or non-collateralized assets, which then increase the risk for the overall banking system.

The fourth weakness of the regulation is the absence of differentiation of loan portfolios by maturity structure. This again provides incentives for longer-term lending which extends portfolio maturity and portfolio risk respectively; hence the risk for the overall banking system.

The fifth major weakness of the regulation is the absence of differentiation in the currency structure of loan portfolios and the lack of a requirement for balancing of the currency structure of assets with the currency structure of liabilities. Under such circumstances and based on requirement 2 (b), banks have incentives to borrow from abroad in foreign currency, thus increasing their foreign currency payables and significantly raising the currency risk of the banking system and the economy. When banks lend in Bulgarian levs, the banking system bears directly the currency risk – a possible devaluation would result in a banking collapse. When they lend in foreign currency, they transfer the risk from the bank onto borrowers. One way or the other – the risk does not disappear, it is only transferred from the banking system to the rest of the economy. In case of Bulgarian lev devaluation, borrowers will prove to be insolvent, and the result will be the same – a banking collapse. It is important to emphasize that the above-mentioned devaluation is only hypothetical– devaluation is not expected and we have no projections for such a devaluation. Yet, we would also like to stress that with a fixed exchange rate, even under the currency board arrangements, currency risk does not disappear completely and should be taken into account as a potential risk.

Results from the regulation. Since coming into effect on 1 April 2005, what has been observed is an explosive growth of lending aimed at raising the reference base for calculation of the credit growth rate. As already noted, this is a credit growth rate of 15 per cent for one month. It seems that the regulation in this form not only did not have any effect, but quite to the contrary – it led to a record increase of lending in March. Some of the schemes for artificial “boosting” of loans have now become clear.

The first mechanism for artificial boosting of loans is renegotiating the amount of existing credit exposures. Under the threat of credit tightening, banks gave the chance to larger customers to renegotiate the amount of their loans, and quite a few corporate customers took that chance.

The second mechanism for artificial boosting of loans used by banks was the use of available credit lines from their customers, the amounts of which were deposited in the bank.

Again under the threat of tightening the lending policy and shrinking the unabsorbed credit lines, quite a few customers availed themselves of the “chance” to utilize funds from the credit lines in order to avoid losing a part of their credit limits. Since they did not need these funds at the time, the borrowed funds were deposited in the lending bank, thus reconfirming unambiguously their intent to circumvent the regulation.

The third mechanism is a variation of the second one. Banks boost the credit limits on already fully absorbed credit lines, and customers make use of the new opportunity to borrow.

The fourth mechanism of artificial boosting of loans is remarkable for its unique simplicity and efficiency. Corporate customers agree on a short-term loan that is deposited in the lending bank in another type of account as a collateral for the loan. Later the deposit is used for repayment of the loan. This is simply debiting of an asset account and crediting of the respective liability account before “cut off”, and later reversing the accounting transaction.

The fifth mechanism for artificial boosting of loans is a variation of the fourth one. A corporate customer is given a loan before the cut off under the obligation to purchase government securities. The customer deposits the government securities as a collateral for the loan with the lender. The government securities are liquidated after the cut off and the loan is repaid. BNB inspections found that in such types of manipulations the interest on the loan is equal to the yield of government securities. This again proves doubtlessly that the transaction was intended to boost the base and circumvent the regulation.

The sixth mechanism of artificial boosting of loans is the consolidation of subsidiaries’ portfolios. Thus, credit growth starts from a higher reference base. In addition, soon they will find a way to separate subsidiaries off-balance sheet or simply not to consolidate any more.

The seventh mechanism of artificial boosting of loans is looser lending: loans are made which under “normal” conditions would not be.

In addition, many ways exist to increase the lending capacity of banks. Most important of which are the following: (1) increasing borrowed capital by borrowing from abroad, (2) increasing borrowed capital by credit-like provision of resources by the headquarters of foreign parent-banks, (3) increasing equity through issuing new shares, (4) increasing the deposits through the launch of new deposit products.

Projections for the growth of lending. The above weaknesses could be eliminated only by additional administrative restrictions. This is so, because natural market mechanisms limiting credit expansion are fully eliminated in the “modern” banking system, including the Bulgarian one. Currently, there does not exist a restricting market mechanism which gives us grounds to believe that even though additional administrative measures would mitigate or even eliminate the above listed weaknesses, these could hardly be efficient to retard credit growth. When commercial banks have interest in aggressive credit expansion, they will find their ways around administratively-imposed restrictions.

Our expectations about lending growth rates are that the regulation in its current form will not have any effect towards the reduction of growth. Under these circumstances, it needs "fixing", and fixing it soon. Probably BNB will issue a modification of the present regulation or a new regulation as early as the end of April or beginning of May. However, we have doubts in the possibility for success by purely administrative measures, unless large banks are convinced to accept the restrictions. In the end, credit growth will be dictated by the market and not the Central Bank.

General trends

During the first months of 2005, despite the positive signals and steps for development of the capital market in Bulgaria, it was for the first time over the last several years that a more continuous decline occurred in certain indicators of the stock exchange trading. Capital market's share to the overall financial intermediation grew but continues to remain strongly limited compared to the banking system. At the end of March 2005 the general market capitalization of the Bulgarian Stock Exchange - Sofia AD was 21.14 per cent of the estimated[30] GDP for 2005.

Thanks to the approval of BTC shares for trading, market capitalization of the stock exchange marked considerable growth over several months, but it deserves noting that the average traded free volume of companies of BSE-Sofia is hardly between ¼ and 1/3 of the average capitalization[31]. Trading on BSE-Sofia has been active since the beginning of the year, and despite the current decline, on an annual basis there is growth in the turnover, volume, market capitalization, and the stock exchange index. Trading in compensatory instruments reached its climax in January, and the positive development of the sale of the last tranche of the state-owned interest of BTC resulted in record high price rise. Despite improving indicators, there remains the need for active measures by institutions and market players to preserve and expand the existing potential of the stock exchange.

The capital market has a relatively low share among the alternatives for financial intermediation in Bulgaria. This conclusion stands valid in comparison with other European countries, including new EU Member States. Both in absolute and in relative terms, the capital market in Bulgaria ranks last among EU Member States and other applicant countries (Table 10). This condition of the capital market is not explained so much with the immediate prospects for the Bulgarian economy as a whole but rather with the circumstance that mechanisms of financing through this alternative non-banking environment remain unknown or non-preferred even with the availability of good investment projects. According to a survey conducted at the end of 2004[32], about 65 per cent of the population of the country does not know anything about shares and hardly 5 per cent sees them as an opportunity for a profitable investment. In addition, 80 per cent of the interviewed representatives of the business in the country state they are not aware of issuing shares on the stock exchange as an alternative way of financing.

Even with continuing, positive macro-economic development or development in certain industries and enterprises, effects on the capital market may be insignificant or displayed with long delay.

Table 10. Market indicators in EU Member States, Bulgaria and other applicant countries (end of February)

	Market capitalization, EUR b	Market capitalization,% of GDP
Euro zone (12), total*	4360.51	57.76
EU (15), total *	6821.63	70.1
EU (25), total *	6954.55	-
Bulgaria**	**1.13**	**5.76**
Estonia*	4.41	49.86
Cyprus	4.06	32.77
Latvia*	1.15	10.36
Lithuania	5.46	30.43
Malta	2.32	53.53
Poland	57.75	29.59
Romania	13.65	24.08
Slovak Republic	4.3	12.98
Slovenia	7.22	27.89
Turkey	87.37	35.72
Hungary	26.08	32.46
Czech Republic	37.1	43

* As of end 2004
** Official market

Source: Eurostat

Liquidity is increasing, but remains low as a whole and market incentives are still not sufficient for the establishment of good practices of corporate governance even in some public companies. Investment alternatives remain limited and financial intermediation in Bulgaria is still provided predominantly through the banking sector.

Stock exchange trading (excluding the privatization market and the market of compensatory instruments and investment vouchers)

Market capitalization. As of the end of March, according to stock exchange data, market capitalization amounts to a total of BGN 8 739 244 552 (out of BGN 2 079 945 650 on the Official Market), while at the end of 2004, market capitalization totaled BGN 4 033 204 800 (out of BGN 1 374 876 944 on the Official Market). Capitalization has also grown considerably for the year (Figure 10).

Trading turnover. The trading turnover during the first three months of 2005 amounts to BGN 364 123 631 with 21 831 968 traded securities (lots)[33]. This trading volume does not include

30 MoF estimates, macro framework from the Report on the State Budget Act 2005

31 End of 2004

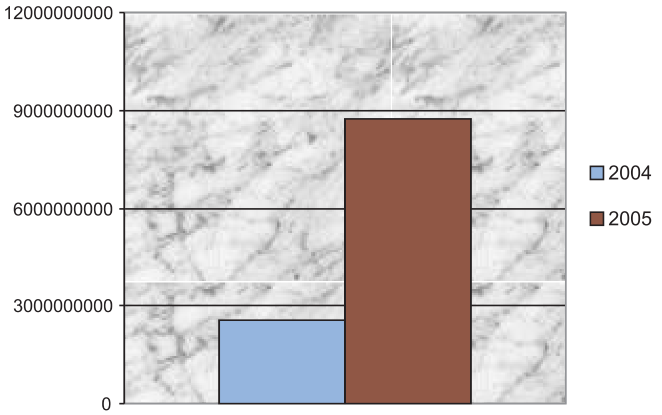
32 Survey of the attitudes to the capital market conducted by order of BSE-Sofia by Estat Agency in November-December, 2004

33 Official and OTC market of shares.

the privatization market, nor rights, compensatory instruments, and investment vouchers traded on the stock exchange. This presentation of the turnover does not cover block and other negotiated transactions. On an annual basis, this represents a turnover increase by 221 per cent (Figure 14).

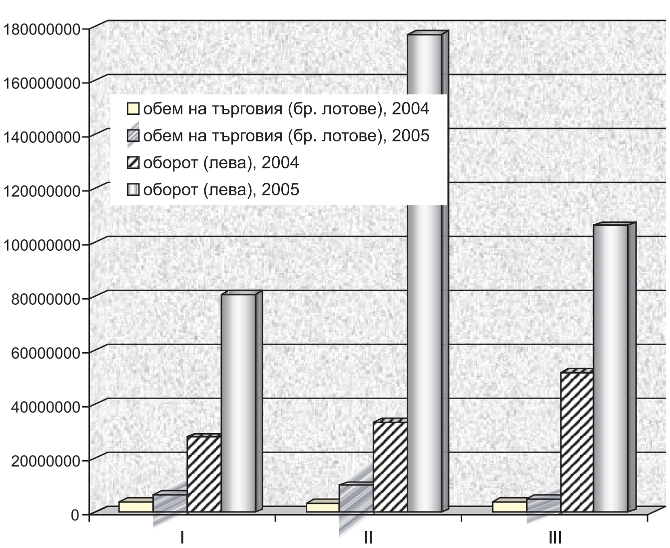
Trading volume, again, on an annual basis grew by 89 per cent for the first three months of 2005 (Figure 15).

Figure 14. Total market capitalization (BGN, end March)



Source: BSE – Sofia

Figure 15. Summarized indicators of BSE-Sofia

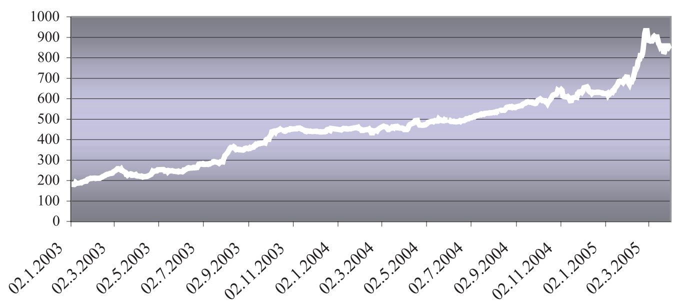


Source: BSE – Sofia and proprietory calculations

The significant total growth of BSE-Sofia indicators (those traditionally measuring and characterizing the condition of the capital market in Bulgaria) versus the previous year are largely due to the acceptance of trading of BTC shares.

In addition, the very increase of prices of many of the traded securities, with actually unchanged liquidity, explains a portion of the growth in the total turnover. In reality, however, it was exactly during the first three months of this year that the SOFIX index suspended its rise for a lengthier period of time (Figure 16).

Figure 16. The SOFIX index (1 January 2003 – 31 March 2005)



Source: BSE – Sofia

Liquidity. Increased liquidity, however, still applies differently to individual items. Therefore, low liquidity remains among the major problems of the market regardless of the positive trends. The number of issues listed for trading is still high but liquid items are few in number (these are most of the securities included in SOFIX in addition to some of the former privatization funds). Occasionally this presents a distorted picture of the actual activity of stock exchange trading.

BG-40. As of 1 February, BSE-Sofia started to calculate a new "broadened" index, the so-called BG-40. At the end of January the stock exchange announced those 40 companies included in the new index. These are the 40 most liquid companies, and the list will be updated every 6 months. The criterion for liquidity is the number of transactions with company's shares for the last half a year; in case a company does not meet the criterion for liquidity, it will be replaced by a company of higher liquidity.

The index starts at a basis of 100 basic points, and companies participate with an equal weight of 2.5 per cent each in defining its value. The new index was presented also as a part of the preparation for derivative instruments trading on BSE-Sofia, although no particular plans have been announced so far for introducing such trading.

Quarterly financial statements. Financial statements of public companies were again among the important corporate news concerning trading. It has been a fact for several years now that market players need and carefully follow the fundamental factors influencing share prices (according to the financial information from the statements and news surrounding traded companies). Stock price dynamics, in particular with liquid items, increasingly reflect corporate events, which is a sign of an enhanced corporate culture of market participants and higher overall market efficiency. Timely submission of financial statements is already a practice for most of the public companies, which to some extent is due to the gradual awareness raising of the importance of good corporate governance in favor of both minority and potential shareholders. However, FSC continues imposing individual administrative acts obligating various companies to submit non-submitted statements for past periods or to eliminate shortfalls in submitted statements.

Compensatory instruments. Trading in compensatory instruments on the Bulgarian Stock Exchange-Sofia AD remains among the leading events in the area of capital markets. Interest in compensatory instruments trading as of the start of 2005 was comparable to shares trading. As much as such interest has always been directly dependent on the progress of stock exchange privatization (especially the sale of larger blocks of shares of more attractive companies) in which payment in compensatory instruments is expected, in parallel with the BTC sale development, trading is being logically accelerated and compensatory instruments are reaching record high prices.

Compensatory instruments in 2004 were traded in the range of 20.48 to almost 100 per cent of their nominal value with a strongly manifested trend of price increase during the last two months of the year. Since the beginning of the autumn, under the influence of the positive expectations for the forthcoming sale of 20 per cent of BTC on the stock exchange, compensatory instruments' prices started to rise. Interest towards compensatory instruments at the end turned into euphoria. BTC's registration as a public company by the Financial Supervision Commission in November 2004 additionally accelerated the price rise. The last powerful push came from the decision for sale of the last 15 per cent of BTC on the stock exchange against compensatory instruments. In the beginning of 2005 compensatory instruments prices rose over the nominal value, and just before the auction for BTC they reached their maximum level of 113 per cent of the nominal value. After the privatization of BTC, prices of compensatory instruments marked a decline.

The sale of BTC through the stock exchange will be remembered as a key event in the contemporary history of the capital market in Bulgaria. A total of 2 869 251 shares representing 34.78 per cent of the capital of the company were sold against compensatory instruments for the four working days from 27 January through 1 February 2005. The government kept only the golden-edged share to enforce compliance with privatization commitments by the majority shareholder. BTC's shares commenced trading on the OTC market of the stock exchange as early as 27 January, and after a sharp rise to BGN 206 per share (the price of the first realized transaction), the price settled at BGN 300.

The auction for the sale of BTC shares was conducted smoothly and presented a solid proof so far of the efficiency of the exchange systems for placing orders and trading, as well as of the potential of the Bulgarian capital market for realization of large privatization deals. Following the start of secondary trading in BTC shares, turnovers, volumes, and the market, capitalization of BSE-Sofia marked notable growth. The general interest of investors and observers, including foreign ones, to the capital market grew as well. In this sense, the prevailing expectations are that BTC will have a long-term positive effect for the market.

Beyond the unquestionable improvement of many of the aggregate indicators of BSE-Sofia, some of the positive attitudes and assessments of BTC's presence on the stock exchange are still to be proven. In the beginning of February, the Central Depository announced the shareholding structure of BTC after completion of the exchange privatization. It has shown that BTC had only 1 176 shareholders after the end of its auctioning. Among these were three Bulgarian pension funds (with a total of 2 649 shares), six Bulgarian banks (a total of 72 405 shares), two Bulgarian insurance companies (312 shares), two investment companies (with a total of 1 934 shares), a Bulgarian holding company (with 312 shares) and 1 050 Bulgarian individuals with a total of 145 829 shares. These data provided grounds for the first opinions that the free volume of BTC is much smaller than probably supposed in privatization through public offering. Mass investors actually have insignificant presence in the company and from now on, according to some of the observers, prices on the secondary market will be determined by several larger investors.

Regulatory framework development

Following the commencement of some serious amendments in the secondary legislation of the capital market in Bulgaria in the second half of 2003, in 2004 FSC continued the work on its further development. The Ordinance on the procedures for margin purchases, short sales, and securities loans was promulgated in 2004.

Harmonization of Act on IPO. Experts of the Commission developed and submitted for public debate a draft of the Act on Amendments to the AIPOS. As noted in the official argumentation of the project, these amendments are aimed at harmonization of the Bulgarian law with *acquis communataire* in the area of securities or improvement of the existing regulatory framework in our country. The major amendments can be summarized in the following areas: (1) changes in the regulation of operations and capital requirements to investment intermediaries; (2) setting up of a Compensation Fund for investors in securities; changes on the part of public companies (mainly with regard to the procedures for their transformation); (3) introduction of a new type of scheme for collective investment in securities (contractual fund); and (4) changes on the part of managing companies.

Relieved deregistration of companies. The draft law introduced in the Parliament provided for a change that immediately turned into the most controversial public issue. AICB insisted that the draft law contain a possibility for a relieved deregistration of certain public companies from the registers of FSC. This idea reflects the attitudes and perception of a burden related to the public status of a company among quite a few issuers and their management bodies – attitudes that are definitely not related to the active presence of such issuers on our capital market.

However, on the other hand, confidence in the capital market is a key factor for its development. That is why any extreme (or even a compromise) resolution of the issue of stock exchange presence of low liquid companies or companies in a less favorable financial condition should take into account first of all the interest and equality of all of their shareholders.

Privatization of BSE and CD. The last important change proposed in the draft law on amendments to the AIPOS is related to the possibility for sale of the state-owned interest in BSE-Sofia and CD. In view of the decreasing role of the state for immediate impact on the capital market, as well as due to the fact that there is already a well built up market infrastructure in place, such a decision may be assessed as positive. Such a development may have an effect on the market in the following several directions.

First, privatization of the stock exchange and the depository may accelerate or operate in parallel with certain forms of regional consolidation. Second, privatization may create additional incentives to enhance the efficiency of stock exchange operational management. Third, depending on the prospects of BSE-Sofia also going public (e.g. in addition to its privatization), the anticipated effect could be improvement of the corporate management of the stock exchange itself with all the ensuing advantages for the Bulgarian market. Last but not least, the participation of the depository in the stock exchange privatization, together with the possibility for distribution of their financial result, may additionally encourage their members to take a more active role in the very capital market.

In March the Parliament passed at first reading the draft law, and currently its provisions are discussed in the Economic policy commission.

Analysis and Development Strategy for the capital market by 2007

Development of the analysis. In October 2004 BSE-Sofia assigned the Center for Economic Development and Economica Agency with the development of Analysis, Strategy, and Program for development of the capital market in Bulgaria by 2007. The Analysis and Strategy are already prepared and submitted for approval to the Board of Directors of the Bulgarian Stock Exchange – Sofia AD[34]. The Board of Directors approved in March the two documents and published them in the website of the stock exchange, thus providing the foundation for a wider debate and elaboration of a detailed Program for development of the capital market.

Scope of the analysis. The situational analysis was generally focused on the following:

- Review of existing analyses of the Bulgarian capital market;
- Analysis of up-to-date summarized indicators (liquidity, capitalization, volume, and turnover) of the Bulgarian Stock Exchange - Sofia AD;
- Comparative analysis of the trends and prospects of markets in CEE and in Bulgaria;
- Sociological and market survey of attitudes towards the capital market (and to the stock exchange, in particular) among members of the exchange, brokers, investment consultants, public companies, as well as among several hundred non-public Bulgarian companies (a representative sample of the Bulgarian economy); sub-contractor along this line of the project is the Estat Agency for Market and Sociological Research;
- Review of the commitments undertaken by Bulgaria in the EU accession negotiations and in general – of processes of building up the Single Market for financial services in EU and respective challenges to the Bulgarian capital market;
- Conclusions about the competitive pressure on the Bulgarian Stock Exchange – Sofia AD in the mid-term;
- Review of the prospects for establishment of strategic partnership with EU markets.

Development lines. The analysis provides justification for and is complemented by the Strategy for development of the capital market by 2007. The following possible strategic lines of development have been offered for discussion to the management of the stock exchange and all the stakeholders.

First, attraction of new issuers is critical. The absence of adequate interests with issuers to raise capital through the stock exchange remains still a major problem. That is why there are no sufficient free volumes of attractive shares from most of the issues, despite some positive trends. Attracting new issuers to BSE-Sofia should be perceived as a primary challenge.

Second, tax incentives not only for issuers but also for investors and various groups of intermediaries remain an underutilized but powerful mechanism to encourage the market. The strategy proposes five specific actions for tax stimulation – (1) relief for public companies – issuers; (2) privileges for individuals investing in securities on the stock exchange (similarly to payments into voluntary social and other insurance); (3) tax exemption of dividends from investment companies; (4) tax exemption of income of companies with special investment purpose, and (5) limiting the amount of the negative difference by which the financial result is increased for tax purposes (for legal entities trading in securities on the regulated market).

[34] The Analysis and the Strategy for development of the capital market in the form disseminated by the stock exchange can be unloaded from CED's website at http:/newwww.ced.bg/NEW_CED/CM_analysis_final_short.pdf

Third, there are several organizational and structural groups of changes for BSE-Sofia recommended with regard to its strategic interest. The stock exchange can activate its efforts to attract new issuers (even at the cost of strengthening the resource capacity by setting up a new department for attraction of potential issuers). Due to the possibilities for manipulation on the market, BSE-Sofia may undertake measures to increase the supervision capacity. Probably some initial publicly disclosed cases of sanctions imposed by the stock exchange in such occasions would have particularly disciplining effect. The stock exchange may also undertake measures to enhance the analytical and research capacity. The last development of organizational and structural nature that would have a more immediate effect on the market is the integration of the stock exchange and depository. This can be a lengthy and stage-by-stage process, but the documents outline the arguments in its favor.

At the beginning of the year the key event in the energy sector was the cabinet reshuffle. This enabled Miroslav Sevlievski and the political party "Novoto Vreme" to determine government policy in the energy sector by the end of the term of office of incumbent government. In turn, former minister Milko Kovachev headed the Bulgarian economy. From public statements made by the new minister it is clear that no dramatic changes could be expected in the government policy pursued. The remaining three months until elections are another factor constraining any substantial manoueuvres.

Electricity Market

As the necessary legal framework establishing market relations in the sector was put in place last year, this year the searchlight turned on market operation. Theoretically it is "open" since mid-2004. If we pay more attention on actual results, however, we could note that at this stage there is no real competition both among sellers and buyers. There are no changes in electricity prices in the free market segment.

In the context of existing constraints in the country, about 30 private enterprises are entitled to negotiate freely electricity prices. Just one-fourth of them participate actively on the market. On the supply side there are three players: Kozloduy Nuclear Power Plant, Maritsa Iztok CHPP and Varna CHPP, which are still state-owned.

The market is still inefficient. This is evident from the quantity of electricity traded on a market principle. It accounts for 22 per cent of total consumed electricity in the country. If we assume that the volume of freely negotiated electricity has increased by some 50 per cent since the beginning of the year, for the same period the number of active buyers has increased from six to eight. Given the above data and the fact that large industrial enterprises do not show interest in the free market, a disturbing trend is in place. If large industrial enterprises consider the idea of participating in the free market unattractive, a subsequent opening of the market to smaller companies and household consumers seems pointless.

Attention should also be paid to the prices formed on the free market. We should note that the electricity market in Bulgaria consists of two segments: (1) *regulated segment,* where electricity is purchased/sold at prices set by SEWRC and (2) *free segment,* where prices are formed on a market principle. In turn the free segment consists of two sub-segments. The first sub-segment is associated with initial negotiation of quantities and prices between the buyer and the seller for a specific period. When the buyer fails to use the ordered quantity of electricity, the unsold portion is sold to the second sub-sector – the balancing market. Likewise, when the buyer has deficiency in initially agreed electricity, it is supplied from the balancing market.

In case of shortage of electricity, following the market rationale, the prices at which the buyer purchases electricity on the balancing market should be higher than those initially negotiated and the prices at which the buyer sells extra electricity should be lower. In practice, however, it turns out that in electricity shortage the prices on the regulated market at which producers can sell their electricity are higher than the prices on the balancing market. In other words, regulated prices are higher than market ones which means that prices set by the state regulator are artificially overstated. Therefore consumers have incentive to shift from their regulated market supplier to a free market supplier. Since no user has changed its supplier so far, the market is not functioning efficiently. Given the significant government intervention in the market in one form or another, this picture is likely to change only after the state withdraws from this sector.

Natural Gas Market

A step forward was made in the field of gas distribution. In competition with other four companies with serious interests in the Bulgarian energy sector, the Italian company Gruppo Societa Gas Rimini SpA. was the winner in the bidding for the construction of gas distribution network on the territory of Trakia region. The serious interest was provoked by the large number of potential household and industrial customers. A similar, even stronger interest could be expected in the bid for Serdika region. In the short and mid-term positive results are associated with engagement of work force during construction and erection work, and in the long term, with lower costs of energy sources for households and industry in the respective regions.

Regional Energy Market

Clearly, the pace of electricity market liberalization is rather slow. At this stage the necessary infrastructure for establishing a natural gas market is not in place. This questions the implementation of a regional energy market in South Eastern Europe. Nevetheless, a draft Treaty on Energy Community including Albania, Bulgaria, Bosna and Herzegovina, Croatia, Serbia and Montenegro, Macedonia, Romania, and the UN Mission in Kosovo (UNMIK) on one side and EU on the other side was signed on 22 March 2005 in Brussels. Turkey was also invited.

If this event demonstrates the great desire at government administration level to establish a single market, the same is not true for market participants at national level.

Table 11. Electricity market in South Eastern Europe

Electricity market at the end of 2004		
Country	Extent of market opening based on documents (%)	Consumers having changed their supplier (%)
Albania	8	0
Bosnia and Herzegovina	0	0
Bulgaria	22	0
Kosovo	NA	NA
Macedonia	18	0
Romania	33	22
Serbia and Montenegro	0	
Croatia	0	0
Average for South Eastern Europe	11.6	3.1
EU-25	73	23.6

Source: Technical Annexes to the Report from the Commission on the Implementation of the Gas and Electricity Internal Market.

As shown, at present the average opening of electricity internal markets in South East European countries is 11.6 per cent. This is an indicator of the total quantity of electricity that could be negotiated freely. At the same time, it became clear that in Bulgaria actually negotiated quantities account for one-fifth of the extent of market opening shown in the table. Absence of market relations is even more clearly displayed in the second column showing that only buyers in Romania have changed their suppliers. These results require strengthening of efforts in individual countries in analyzing the obstacles to market relations development and their rapid removal so that liberalization would make sense both at national and supranational level.

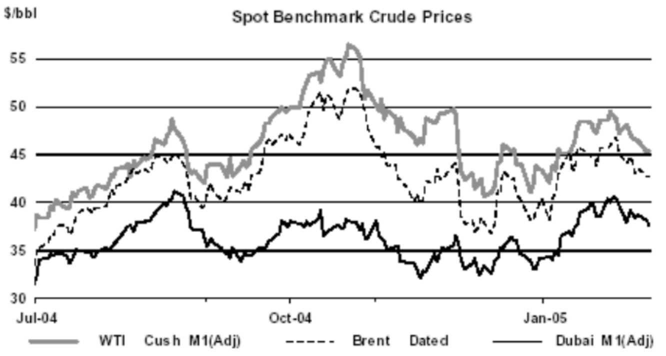
A positive sign of the dynamics of the energy sector was the news about the formation of an energy cluster within Maritsa-Iztok complex. Future expectations relating to the pooling of 40 companies will be associated mainly with economies of scale. The economies of scale may be the result of lower unit production costs, cheaper financing and possibility to enhance the competitiveness of the enterprises within the cluster in internal and international markets.

Prices of Energy Resources and Electricity

Oil. At the beginning of this year oil quotations tended upwards, after oil gave the global economy a sniff of fresh air at the end of the past year. Lower supply in early 2005 and low temperatures pushed up oil prices to levels of some USD 50 per Brent barrel. Higher prices on international markets reflected on the prices of raw material and liquid fuel in Bulgaria since internal needs are met entirely by imports.

Trends in oil price fluctuations are transferred in Bulgaria through the dollar exchange rate. Since the beginning of the year the dollar marked an increase of some 2.7 per cent, while the price of Brent crude oil rose by over 20 per cent.

Figure 17. Spot Crude Oil Price Dynamics for WTI, Brent and Dubai Grades

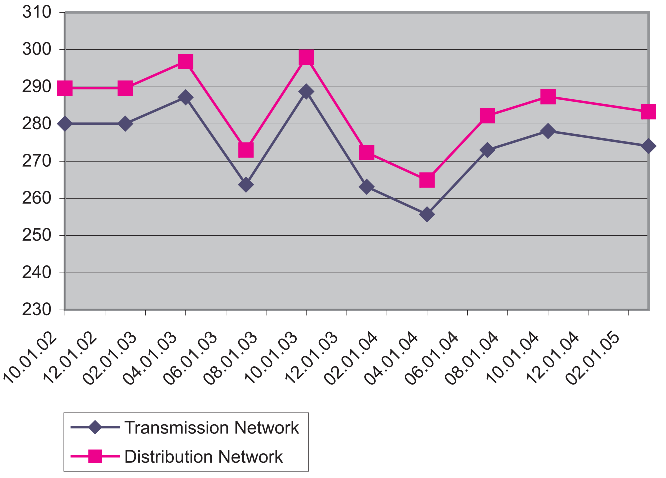


Source: Monthly report on crude oil prices, International Energy Agency, February 2005

This led to fuel price rises on the territory of the country. This would reflect most significantly on the costs of companies providing transport services. If high fuel quotations sustain and the US dollar appreciates, prices of goods will increase.

Natural gas. Gas is another major energy resource for the Bulgarian economy. Gas prices affect most significantly the costs of heat distribution companies, fertilizer and cement plants and the glass industry.

Figure 18. Prices of natural gas in 1000 BGN/m^3 for consumers connected to transmission and distribution networks:



Source: SEWRC

The reduction is minor and will not affect seriously the financial resuls of the above-mentioned companies.

Electricity. Another issue that stirred public opinion in Bulgaria is a possible removal of the lowest price threshold (up to 75 kWh) for household electricity since the beginning of 2005.

Table 12. Prices of electricity for households

Measurement	Time zones	Monthly consumption	Price (BGN/kWh)
With two scales	Day-time	up to 75 kWh	0.098
		over 75 kWh	0.174

Source: SEWRC

Existence of a threshold below which the quantity of monthly consumed energy is paid at prices which do not cover the cost of generation is a government subsidy. However, this is not a special-purpose subsidy, i.e. all consumers will benefit from it regardless of whether they belong to disadvantaged groups[35] or not. At the same time, energy benefits in the form of cash and solid fuel are granted. Removing this threshold, saved funds could be shifted in the form of special-purpose subsidies to the persons in need. Reduction of electricity prices from the next threshold is being discussed, which will average the price of electricity for households. Therefore, the greater the quantity of electricity consumed by a household, the more favorable will the suggested change be for it. At the same time households with lower consumption will be on the losing side.

[35] To disadvantaged groups belong the socially disadvantaged persons, disabled and all other groups of society entitled to state aid.

Government attempts aimed to make up for the slowdown in attracting private capital continued. Main efforts were focused on granting under concession port terminals, Somovit[36] *and Lesport*[37]*, as well as the terminal for hazardous cargo in Varna-West Port. The concession procedure for Varna and Bourgas airports continued. A major event which provoked serious controversy was the concessioning of Trakia Highway.*

Water transport. The volume of cargo transported by sea "from" the country increased by 15 per cent over the past four years. Almost the same increase, 16 per cent, occurred in cargo "to" the country. At the same time, the increase in river exports was 160 per cent and in imports 27 per cent.

Figure 19. Sea Transport in thousands of tones

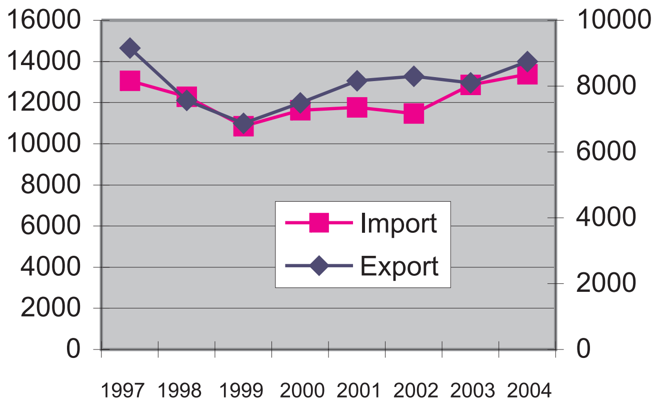
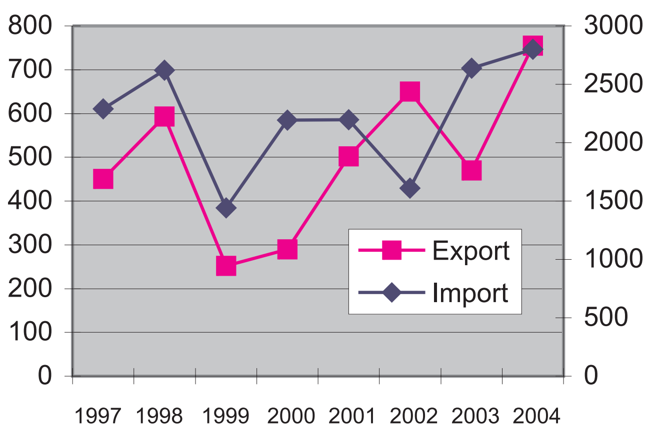


Figure 20. River Transport in thousands of tones



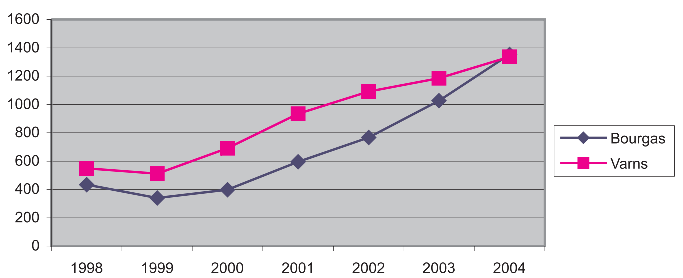
Source: Ministry of Transport and Communications

Growth is due to overall economic dynamics over the past several years. Expectations about preserving economic growth in Bulgaria in the mid-term give us ground to asssume that positive trends in water transport would sustain. Another factor underpinning this argument is the continuously growing share of water transport in the total volume of transported cargo. This provides opporunities for higher profits of companies managing port terminals.

Port concessions. The first real step towards attracting private companies in port activities was made in the beginning of this year. In January the CoM made a decision on granting under concession the terminals Lesport and Somovit. A month later the government opened a procedure for granting under concession a terminal for hazardous waste within Varna Port. In this case the concession includes management and construction of the terminal. Bidding procedures for the three terminals have been announced. Ten companies have submitted tender documents for participation in the bid for Somovit terminal. The contracts for the three terminals might be signed by the end of the term of office of this government.

Air transport. Air transport also marked a substantial growth in recent years. In 2004 the number of passengers serviced by the airports increased almost four-fold compared with 2000. At the same time, we expect the number of tourists who account for the bulk of passengers passing through the airports, to increase in the future.

Figure 21. Passengers who have past through airports in thousands of persons



Source: Ministry of Transport and Communications

Removal of bilateral agreements as a principle of destination allocation among different companies will have a major impact on the load of Bulgarian airports. At present the government determines which companies may fly on specific destinations. This government privilege will be removed with Bulgaria's accession to the EU. This would enable airlines to provide services on destinations of their choice. This would enhance competition among them and in turn would put pressure on the air fares and contribute to an increase in the number of passengers.

Airport concessions. The substantial increase in passenger flow in recent years entails expansion of the capacity of the two Black Sea ports of Varna and Bourgas. Granting the airports on concession is necessary for the development of air transport and sea tourism.

Concessions of Varna and Bourgas Black Sea airports was the other key event associated with reduced government intervention in the transport sector. Four candidates reached the final stage in the bid for the two airports: (1) consortium of Vinci Airports, France, and Vinci Concessions, France; (2)

[36] Part of public transport port of national importance – Ruse, http://www.port.bg/bg/ruse.htm

[37] Part of public transport port of national importance – Varna, http://www.port-varna.bg/

consortium of Hochtief Airport GmbH, Germany, and Albena AD, Bulgaria; (3) Consortium of Fraport AG Frankfurt Airport Services Worldwide, Germany, and BM Star EOOD, Bulgaria; (4) Copenhagen Airports A/S, Denmark. Ultimately the concession was awarded to Copenhagen Airports of Denmark.

The Danish company has proposed to make investments of EUR 526 m for the two airports for the entire 35-year period of the concession. The concession payment due by the company to the State for the entire term is estimated at EUR 1.2 b. According to the minister of transport, the concession contract will be signed by the end of April and airport charges will be reduced in the future.

Concession of Trakia Highway. The contract on granting Trakia Highway under concession was signed at the end of March. Even after contract signing there was no clarity as to the financial parameters of the concession, construction and everything related to the highway.

Experts, many political forces and the media declared the concessioning of Trakia Highway a "non-transparent procedure". Non-transparent for sure but there was no procedure at all. A procedure is in place when consecutive steps are undertaken leading to particular outcome. In this case there was direct transition from the initial decision to the final result.

According to the provided information on the financial parameters of the concession, one kilometer of the highway will cost about EUR 2.7 m[38].

Table 13. Cost per 1 km[39] highway in EUR in US

	1998	2002
Average	764928	1115360
High[40]	1529856	1673280

Sources: Status of Nations Surface Transportation Systems and conditions; Highway Construction Cost Comparison Survey

At the same time, similar statistics on the US in the table above show that the costs are at the average level. As the average cost in the table is based on 25 states with diverse surface, we could assume that as a result of the averaging we have a surface which is not very different from the Bulgarian one. However, if we take into account that labor force and materials to be used in the construction in Bulgaria are much cheaper than those in the US, it could be stated that the cost quoted in the media is comparatively high.

Similar conclusion was drawn by the Bulgarian representative office of Transparency International Bulgaria. Transparency International is the organization which investigates the legality and feasibility of Trakia Highway concession. The analysis and results of the investigation were presented in an interim report in April. The main conclusions of the report are four[41]:

1. "There is consensus among the professional communities in the country and abroad about the lack of feasibility in the construction of Trakia Highway on a concession principle.
2. The estimated traffic on Trakia Highway is considerably overstated.
3. The construction cost of one kilometer of the highway is considerably overstated.
4. The financing schedule is unprofitable."

The intentions of "Transparency without Borders" are to prepare a final report when the specific parameters of the concession contract become available.

38 We assume that this is the cost of 1km highway road with four lanes.

39 One lane. The information for 2002 is about 25 states. The information for 1998 is directly used summary information.

40 The high cost represents the arithmetic mean of the costs which are higher than the median case.

41 Interim report on the investigation of Transparency International Bulgaria of the problems related to the construction of Trakia Highway as a public-private partnership between the Republic of Bulgaria and Avtomagistrala Trakia AD.

Building ICT cluster. In the first quarter of 2005 the Bulgarian ICT sector witnessed a couple of important events. Critical to future sector development is the launched idea to build an ICT cluster, which should support and facilitate the cooperation among Bulgarian ICT industry actors – business, government, academic society, local government, and non-governmental organizations. The first two cluster initiators' projects target two very important economic development aspects – building and promoting public/private partnership and improving training in this economic field.

Educational ICT strategy. No less important for ICT development and expansion in Bulgaria is the National Strategy and Action Plan for Introducing ICT in Bulgarian Schools, approved by the Council of Ministers. The strategy has been developed by the Ministry of Education and Science and the Ministry of Transport and Communications with focus on five basic aspects:

- Creating adequate regulation establishing ICT training and learning.
- Establishing computer classes in all schools, i.e. computerization.
- Building an information network and providing all schools with high-speed Internet connection.
- Training and improving teachers' qualification with a view to introducing ICT in all school subjects.
- Creating an education gateway, distance learning and learning content platforms for all school subjects.

A major strong point of the strategy is the specified amount of funds to be allocated for improving the opportunities of Bulgarian education for ICT use and ICT learning. Some BGN 141 m of allocations from the central budget in the next three years are projected in the plan for purchase of new computers, providing quality Internet access and last but not least, teachers training and retraining. Funds allocated for 2005 amount to BGN 41 m, including BGN 26.5 m for hardware, BGN 7.2 m for Internet access and infrastructure renovation, BGN 3.5 m for teachers training, and BGN 3.8 for purchase of educational software.

Positive is also the fact that real work on strategy goals has started almost immediately – till March MTC had developed project assignments for two aspects – computerization and Internet access. Along the first line, 2480 computer classes comprising 6 – 10 desktop computers (depending on the number of students), a server, a printer and a scanner will be built in 2005. Higher number of computer classes is planned for 2006 and 2007. Introducing Internet in all schools implies:

- All schools having access to European e-learning content;
- All schools having access to Bulgarian e-learning content;
- On-line conference lessons, i.e. Internet open lessons.

To attain these objectives, the project makes provisions for building an integrated communications and content management center, data storage system, illegal or harmful content filtering system, and a hardware and software support center, as well as ensuring Internet connectivity – high-speed access at 1 Mb/sec. The plan for the next three years targets: 1200 schools connected to Internet in 2005, all schools connected to the network by the end of 2006, and connectivity capacity increased twice by 2007.

e-Class. The e-Class project within MTC's e-Bulgaria Program was launched parallel to strategy approval. Like the strategy, the project also targets approaching at accelerated pace the average EU levels in terms of information society development indicators. According to Commission's eEurope+ Progress Report of February last year, in early 2004 there were 2.1 computers per 100 Bulgarian students and with respect to the number of modern computers this ratio is even lower – 1.3 computers per 100 students. Few schools have leased line Internet connection. The e-Class program implies computerization of over 750 schools in 2004 and 2005 (in addition to the figure set forth in the strategy) and Bulgaria's efforts in this respect were duly appreciated in the regular report on information society development in the EU, which states that in the last six months Bulgaria, as well as Hungary, Latvia and Estonia have made progress on many indicators.

National Innovation Fund. The National Innovation Fund within the Ministry of Economy became operational in 2005. Its budget for the current year is BGN 5 m with 20 per cent thereof earmarked for feasibility study projects. The Fund has strictly regulated rules and schemes for project evaluation and project financing. It is administered by the Bulgarian Small and Medium-sized Enterprises Promotion Agency.

It is still early to talk about any tangible results from the measures set forth in the strategy, particularly the innovation fund, yet it is logical to expect improvement of innovation activity indicators at national level, which will of course have favorable effect on the competitiveness of Bulgarian enterprises.

Bulgarian IT market. Data on the Bulgarian IT market were published in February by IDC Bulgaria. According to the analyzing company, trade in computers, software and IT services amounts to BGN 480 m with hardware sales accounting for about 40 per cent of this value. IDC projects 13 per cent growth for 2005 with biggest growth expected in the computers and peripherals market. While published data do not accurately reflect the reality (due to the fact that many companies do not declare their real turnovers) they nevertheless give more or less clear idea of the situation in Bulgaria, still characterized by under-computerization of companies and individuals, which certainly has effect on labor productivity and on the potential of the implemented e-Government.

IT public procurement. In early 2005 MTC and the Bulgarian Association for Information Technologies (BAIT) signed a memorandum of cooperation for future public procurement procedures regarding IT products. The document is underpinned by the idea that the business and the Government should cooperate towards improving the assessment methods and the participation of independent experts in all tender procedure phases. With a view to the increasing number of nationally important government projects in the ICT field, this memorandum is a positive step, which indicates that willingness is present for public/private partnership. We can only hope that this will result in improved and accelerated public procurement processes in the field and in smaller number of invalidated and terminated procedures.

BTC. The long awaited sale of BTC shares on BSE – Sofia became a fact in early 2005. As expected, shares aroused great interest and were sold within a couple of days. The transactions also absorbed a large portion of compensatory instruments, which was some kind of “compensation” for the holders of such instruments.

Telephone services. While the new owner of BTC expressly stated their intent to launch the third GSM operator in April 2005, in the first days of the month it was already clear that this objective would not be achieved. The variance between expectations and reality suggests that although the company has gone private, planning and organization remain unsatisfactory. Instead, April welcomed subscribers with new tariff procedures (time-based), which on the whole means higher prices particularly for local calls. To subscribers’ delight, alternative operators holding fixed telephony licenses began to announce their terms and conditions for the provision of telephone services and real competition can shortly be expected on the market still monopolized by BTC in every other respect.

Mobile licenses. In early April the Communications Regulation Commission (CRC) made a decision whereby it declared Mobiltel AD the successful bidder in the public tender with secret bidding for Class A individual license for provision of telecommunications through public telecommunications mobile cellular network under UMTS standard. Mobiltel AD was ranked first in the bidding with a bid price of BGN 78 m and BTC AD was ranked second with a bid price of BGN 76 m. BTC AD and Cosmo Bulgaria Mobile (Globul) will be officially issued (without tender) the other two licenses class B for the amount of BGN 42 m.

e-Services. At the end of March the Coordinating Center for Information Communication and Management Technologies with the Council of Ministers conducted for a third successive time in cooperation with Estat Agency for Sociological Analyses and Forecasts a survey of Bulgarian e-services. This year the survey was expanded for the first time to cover not only the opinion of the business but also that of individuals. The survey includes a study of the current situation and future trends of e-communication and e-services development, as well as a profile of e-service users. Results reveal that unlike 2004, in 2005 the number of companies relying on documents published on the Internet and not on explanations in direct contact with the corresponding administrative service increased three times. On the Internet managers get information and think it over in advance, which changes the nature of contacts with institutions. The e-services provided by public institutions can be conducted in the form of business services. Avoiding, where possible, direct contact with the administration and replacing it by virtual contact seems an attractive alternative for companies.

Unfortunately individuals are still more pessimistic than the business about the use of e-services. Most of the interviewed think that the personal (on the spot) contact with the public administration is more fruitful and productive. There is lack of confidence in Internet communications, particularly with respect to document processing and fiscal operations. Despite that, the survey reveals that every second individual between 18 and 29 years old and every third between 30 and 39 years old uses Internet. These groups are most prepared to “have a try” and do not worry much that it could disturb their security and assets. The analysis calls for the conclusion that promoting Internet with a focus on user protection would noticeably enhance e-communication with the administration.

Indicative of the changing business – institution communication is the noticeably increasing share of those for whom the first thing to do, when a problem arises, is to refer to Internet – from 8 up to 25 per cent. Building up such a reflex reveals that a mass transition from traditional to e-communication lies ahead. At the same time it is logical to assume that individuals are more pessimistic about e-services for the simple reason that the number and time of an individual’s contacts with the public administration are negligible compared to those of companies.

The mild as yet interest in the e-services provided by the e-Government could be explained by the low Internet prevalence among Bulgarians. According to Eurostat’s latest official statistics (2003) Bulgaria and Lithuania are ranked at the bottom in terms of Internet use by households. The two countries have home Internet access rates of 5 and 6.2 per cent, respectively, versus 25 per cent for most EU Member States. To date the real situation has certainly improved, but in a variety of studies this indicator is hardly above 10 per cent for Bulgaria – a level too low to speak of adequate use of the e-services provided by the public administration.

Latest data on the number of foreign tourists who visited the country in 2004 confirm the positive trends in the development of the tourist sector.

Number of Tourists and Revenues from Tourism

In the period 1998 - 2004 the number of foreign tourists doubled – from 2 million to 4 million persons. According to NSI, in 2004 the number of foreign tourists increased by 13.6 per cent on the previous year, exceeding 4 million persons. Moreover, the number of tourists from almost all countries increased. The increase in the number of tourists from Ireland was most significant (80 per cent), followed by Great Britain (60 per cent), Portugal, France, Austria and Germany.

The number of tourists from the Czech Republic and Poland increased, a sign of Bulgaria's gradual return on the tourist market of Central European countries.

A minor decline in the number of Russian tourists occurred last year, while the number of tourists from Ukraine marked a more significant decline (29 per cent). The reasons for the reduced number of tourists from Russia and Ukraine are associated mainly with the introduction of transit visas by Romania, which led to appreciation of bus programmes.
In 2004 the greatest number of tourists visiting Bulgaria was from Greece (over 700 thousands), Germany, Great Britain, Macedonia, Serbia and Monte Negro, and Russia.

The total number of foreign persons who crossed the country's border in 2004 is about 7 million persons, including about 2.4million transit passengers and about 270 thousands on a business trip to Bulgaria; the other 60 per cent are tourists, i.e. *foreigners coming for tourism and holiday prevail clearly*.

The number of Bulgarians who traveled abroad also increased. Following a decline in the period 1995 – 2000, in 2004 the number of Bulgarians who traveled abroad increased by 14 per cent on the previous year and reached 3.8 million. Bulgarians traveled most often to Turkey (over 1.352 million Bulgarians visited our southern neighbour); followed by Greece, Germany, Serbia and Monte Negro, Italy, Spain, Switzerland, Great Britain, etc. The number of Bulgarians who visited the Czech Republic and Poland decreased.

Of note is the fact that foreigners visit Bulgaria mainly for the purpose of tourism and holiday, while *Bulgarian citizens travel abroad mainly on business trips* – in the past year the number of business trips was over 2.2 million and the number of persons traveling for tourism and holiday purposes was 1.1 million.

In 2004 *revenues from international tourism* amounted to EUR 1,746.3 million, an increase of 20.77 per cent on 2003, when these revenues amounted to EUR 1,460 million.

Expenses of Bulgarians who traveled abroad in 2004 exceeded EUR 775 million, up 17.3 per cent on 2003.

Net income from international tourism in 2004 reached EUR 970 million, against EUR 798.9 million in the previous year, or an increase of 21 per cent.

In the beginning of 2005 the positive trends in terms of revenues from tourism sustained – in January revenues increased by 20.5 per cent on January 2004, exceeding EUR 77 million.
Expenses of Bulgarians traveling abroad also increased, though at lower pace (9 per cent) and accounted for EUR 67 million against EUR 61.6 million in January 2004.

The balance on tourist services in January 2005 amounted to EUR 10 million.

Specialised Infrastructure

In recent years the specialized infrastructure has developed very dynamically both in terms of expansion and renovation and modernization. According to NSI data announced in March, compared with 1996 the number of hotels, motels and mountain hostels in the country has increased by 70 per cent. In 2004 the number of beds reached 190 thousands, distributed among 1,306 tourist sites. Over 50 per cent of the hotels are located on the Black Sea coast, accommodating more than 70 per cent of the beds. Almost all foreigners stay at hotels, a small part (about 2 per cent) prefer camps and hostels.

The hotel base in Sofia also expanded fast in recent years – in 2004 there are 86 hotels in Sofia. In 2002 hotels numbered 62 and a mere 27 in 1998. This means that for a period of 6-7 years the number of hotels almost tripled.

Assessment of the Winter Season

The past winter season was one of the most successful ones for most winter resorts. The reasons are associated firstly with good climatic conditions – good snow cover, and secondly, with expansion and renovation of the tourist base in winter resorts and mainly in Bansko and Pamporovo.

Pamporovo. According to representatives of Pamporovo 21 Century Association this was the most successful season for the resort over the past five years. Approximately 100 per cent of the beds were occupied and the number of tourists increased by 22 per cent on the previous year. Of note is the fact that Pamporovo was visited both by foreign and Bulgarian tourists. The ratio is still in favour of foreigners, 60 to 40, but the share of Bulgarians visiting the complex has increased.

Bansko. The season was very good for Bansko as well. Investments in specialised infrastructure in the recent months exceeded EUR 50 million. In 2004 the municipal administration

issued 274 construction permits, including 79 for hotels. Construction of higher category hotels has expanded – the first four-star hotel “Tanne” opened in 2002.
In the past year and a half Bansko has been developing very dynamically. Unfortunately, the town is not prepared for the large-scale construction – general and transport infrastructure is still insufficient and needs renovation. The water supply and sewerage system is obsolete and needs replacement; staff with good professional and language skills is absent; tourist service is still at low level, etc. There is a risk of environment damage and concentration of substantial hotel infrastructure, which might drive back tourists at certain point in the future. There are also problems arising out of the lack of advertising and promotion of the resort – there are no concerted efforts for Bansko’s overall presentation and advantages.

Borovets. Against the background of accelerated development of the above-mentioned two winter resorts, Borovets is lagging behind – its expansion and renovation are forthcoming. It should be noted that certain progress has been made in the implementation of the Super Borovets project. The concept of modernizing the complex was approved by a working group and its approval by the Council of Ministers is pending. Development of the resort will pass through three stages, the first one due to be completed in 2007. Its implementation will help achieve twice as high employment of the tourist base in Borovets. The second stage will start after clarification of currently existing problems associated with the ownership structure and after adoption of a cadastre plan and a detailed evaluation of the environmental impact. Expansion of the tourist base in the region of Beli Iskar and Samokov will s tart.

In March a public discussion of the environmental evaluation of the Samokov-Borovets-Beli Iskar project was conducted. A significant number of respected environmental organizations supported the project, their main recommendation being to preserve the balance between environment and development. Achieving such a balance will benefit the resort, will create conditions for employment and prosperity of the region.

According to the working group, the overall implementation of the project will result in creating 10 thousand new jobs. This process entails the need of well-prepared tourist staff. To this end, the existing specialized tourist schools in Pravets, Samokov and Pirdop are required to join their efforts. They will train jointly students for the needs of Super Borovets Complex. Such partnership will have a positive effect, reducing unemployment in the regions and improving the quality of service in the tourist sector.

Forecasts about Pending Summer Season

Expectations about the forthcoming summer season are optimistic. However, good expectations are blighted by the ongoing active construction in big sea resorts, which is often indiscriminate and drives back tourists. For example, experts from the Ministry of Culture and Tourism forecast an *insignificant* growth in German tourists. According to preliminary data of Bulgarian tour operators based on bookings for the summer season, the number of German tourists visiting Bulgaria this summer will grow by about 5 per cent, a very low figure.

At present the German market is one of the most important markets for Bulgarian tourism. In the recent years, however, German interest in Bulgarian resorts has declined. Regardless of the difficulties in the economy and the high unemployment level the German tourist market has great potential – in 2004 over 48 million Germans went to at least one holiday. It is expected that in 2005 German tourists will spend over EUR 60 billion on holiday and tourism. In the past year interest in visiting unknown destinations or long unvisited regions increased. Offers are quite diverse, with favourable conditions for transportation and stay. Topical and preferred destinations are Spain – Palma de Mayorka, Turkey, and Morocco. Interest in the USA and other remote destinations has been growing.

Current bookings for Bulgarian sea resorts give grounds to assume that this year there will be certain outflow of German tourists. The reasons are associated with last-year’s construction, noise and dust, unfulfilled promises, irregularities in services, etc. Tourists react fast to irregularities and usually do not return.

One of the main negative aspects of the Bulgarian tourist product driving back not only German tourists – indiscriminate and unregulated construction in Bulgarian sea resorts – has emerged again. The image of Bulgaria as a country with expanding and renovating hotel base is definitely a positive development but the opinion of experts is that Bulgaria should learn to build in a cultural and organized manner. In this regard municipalities in which the big resorts are located were obliged to ensure normal and civilized conditions for tourists’ rest. Deadlines for completion of construction work are set at 1 - 15 May but this might be too late. The season already opened in some resorts – in Albena, for example, the first tourists came as early as March.
Lack of good organization makes it difficult to solve another serious problem in Bulgarian tourism – the short duration of the tourist season. This refers both to sea and winter resorts – impossibility to use the tourist base throughout the year. The tourist product should definitely be diversified with other alternative forms – cultural, agricultural and environmental, attraction tourism etc. so that Bulgarian tourism could adapt to the changing requirements of tourists and develop its competitive advantages.

Alternative Tourism

Efforts at developing alternative forms of tourism – eco tourism, agricultural, congress, cultural and historic, hunting tourism, etc. – have continued.

It is very important for Bulgaria to develop tourism inside the country as it has preconditions for this. Such recommendations were made by representatives of the European Commission on Tourism at a forum held in Sofia in February.

The potential of *congress* tourism has not been exploited yet. This refers to organizing business meetings, company meetings, conferences and other events in the country. According to experts, this kind of tourism may generate revenues for Bulgaria of about USD 100 million per year. While an average tourist spends about EUR 70 per day, the business tourist spends EUR 700 per 3-4 day stay. Prerequisites for development of congress tourism already exist in the country, particularly in Sofia, which has good hotel base, international airport, comparatively convenient transport and communications. Plovdiv and Varna provide similar opportunities. The priority problems to be solved involve provision of cheap air carriers, operating from Western Europe to Bulgaria, active marketing for promoting Bulgaria as a destination of congress tourism. The markets with the highest potential in this niche are Sweden, Germany, USA, Japan and Great Britain. The country should participate in specialized exchanges for congress tourism and pursue a purposeful policy in this respect.

Application of best practices in the area of congress tourism – establishment of congress bureaus, specialized tour operators, creation of database of providers of the product, venues for events, hotels, transport facilities, sub-contractors, etc. – play a positive role.

Changes in the Legal and Institutional Framework

In the first months of the year the legal framework of the tourist sector was amended.

In January the government took a *decision on granting the status of settlement of national importance to 9 resorts*. Having such a status means that only the minister of regional development and public works may assign or authorize development of general and detailed urbanization plans or amendment thereof as well as approve them in conjunction with the municipal council and the National Expert Board on the Structure of the Territory and Regional Policy. The following positive effects are expected: creating better conditions for development of big resort complexes and better co-ordination in implementation of the national tourism development strategy and turning it into an efficient instrument for social and economic growth.

Last year an attempt was made for the first time to proclaim big resorts settlements of national importance by amending the Law on Tourism, but Parliament did not approve it. Initially experts of the ME and hotel owners proposed that big tourist complexes should be granted the status of independent municipalities and use revenues from resort fees for infrastructure renovation and tourist advertising.

This is not a new idea as revenues from resort fees are used by local authorities not for investment in the infrastructure but to cover “gaps” in local budgets. *The facts show that Balchik Municipality, for example, receives about BGN 4 million from taxes and over BGN 600 thousand from resort fees per annum from Albena resort. Varna Municipality and Nesebar Municipality receive about BGN 1 million per annum only from resort fees.*

Subsequently hotel owners themselves gave up the idea of proclaiming complexes independent municipalities due to awkward and complex procedures but still insisted on managing the complexes themselves.

The decision taken by the Council of Ministers would probably solve the problems to a certain extent and would provide the opportunity for these complexes to be safeguarded and the environmental equilibrium and nature in them to be preserved. Dynamic processes and serious transformations in the resorts showed that local authorities were not adequately prepared to manage them.

The Council of Ministers’ decision was not accepted unanimously by the representatives of the respective municipal administrations and by tourist experts. The experts in the tourist sector and the Union of Architects supported it. At the same time, mayors of municipalities from whose territory the resorts will be separated disagreed. In their opinion, the decision is in variance with the policy of decentralization and infringes upon the principles of self-governance.

In February the legal framework was amended, aiming at a more precise regulation of construction in big resorts. *The amendments refer to Regulation No. 7* on the rules and norms for the structure of specific types of territories. The amendments introduce lower construction parameters in resorts in terms of height and density of construction. Density of construction may be maximum 30 per cent, not 50 per cent as it had been earlier. At least 50 per cent of the resorts’ areas must be planted. The new norms for construction will be effective only for future buildings.

The amendments aim at stopping urbanization of resort complexes and vacation settlements, to improve their environment, i.e. they should be preserved as actual places of rest, recreation and leisure.

Of key importance for implementing the policy on tourism is the shift of the tourist sector within the structure of the *restructured Ministry of Culture and Tourism*, made with the latest reshuffle of the cabinet of the Republic of Bulgaria. Expectations are that the “symbiosis” between tourism and culture would have a positive impact, uniting efforts in the two fields.

Advertising and Marketing

Promoting Bulgaria as a tourist destination is among the major tasks of the Tourism Agency. It is the organizer of Bulgaria's participation in international tourist exchanges.

In March Bulgaria took part in the largest tourist exhibition in the world – the exchange in Berlin. The country was represented by 35 companies and two municipalities - Plovdiv and Varna. Traditionally the biggest companies in the tourist industry participate in it. In Berlin Bulgaria was presented as attractive *year-round tourist destination* with the entire diversity of its tourist product.

Bulgaria took part in another major tourist exhibition – the international tourist exchange MITT in Moscow. According to the programme for national advertising on the Russian market for 2005 the country participated with an individual representative booth. The Russian market is one of the most important markets for Bulgaria. Presented were over 60 Bulgarian companies as well as individual municipalities – Sofia, Nesebar, Smolian. Various instruments for promoting the country were employed – advertising films and materials, tasting of Bulgarian wines, independent presentations by municipalities, etc.

Use of *electronic marketing* is of significant importance for improving national advertising. As a member of the European Commission on Tourism[42] Bulgaria could avail of the opportunities of electronic marketing, due to be offered by the organization in October 2005. The European Commission has the important task to position the new markets on the European continent and to present them to the world by means of electronic marketing.

Quality of Human Resources

During the fourth international conference "Bulgaria – Country of Dreams", organized in January the focus was placed *on the quality of human resources in tourism*. In recent years development of specialized infrastructure has been outpacing the quality of service offered. For this reason improvement of human resources gains an ever-increasing importance.

At present there are many specialized schools in the country, with comparatively good level of education. It is necessary to provide opportunities for additional qualification and higher motivation of the persons working in the sector – from senior management staff to waiters and chambermaids. Exchange of staff with respected European educational institutions would contribute to overall improvement of the quality of human resources.

According to representatives of professional organizations secondary education in tourism needs to be improved. A positive impact will have the development of packages of general knowledge and culture of the population about tourism as an economic sector, professions, business, legal framework, environment, resources, attitudes, and markets. Language training and curricula need to be improved as well. This would facilitate start-up of new businesses in the field of tourism as one of the most attractive areas for entrepreneurship.

It would be useful to establish specialized institutions for professional qualification related to *agricultural and other alternative forms* of tourism, which would help diversify the Bulgarian tourist product and expand its geographic scope nationwide.

The analysis of the tourist sector in the first months of 2005 confirms the findings of its dynamic development. This refers mainly to the expansion and renovation of the specialized infrastructure. At the same time, some very serious problems in tourism emerged – unorganized construction in big resorts, impossibility of some areas (mainly road and other general infrastructure) to meet the growing needs of the sector. Difficulties in preserving the environmental equilibrium have worsened further. One of the obstacles threatening the competitiveness of the sector in recent years is the outlining deficiency of adequately qualified work force.

[42] This organization was established in 1948 and its seat is in Brussels. Its goal is to present Europe as a single tourist market to the world.

Share in GDP and GVA

Favorable climatic conditions in 2004 allowed for a substantial increase in the production of most agricultural products compared with 2003. Nevertheless, the share of agriculture in GDP and GVA continues to decline, estimated at 9.5 and 11 per cent, respectively, for 2004 as a whole.

Land Consolidation

Accelerated development of Bulgarian agriculture and the need to enhance its capacity for utilization of European funds clearly outlines the need of land consolidation. A fast solution to this problem would stir the land market as well. After the adopted amendment to the Constitution concerning the possibility for nonresidents to purchase land in Bulgaria the Parliament adopted on first reading amendments to the Act on the Ownership and Use of Farm Land at the end of March. The amendments provide opportunities for transition to so-called municipal land consolidation. A possibility is provided for the residual state land fund to be transferred to municipalities once the restitution process is over. The procedures for land consolidation within a single territory are simplified. These changes are expected to boost the process of land consolidation.

Trade in agricultural products

Increased production ensured higher export potential – total export of processed and unprocessed agricultural products in 2004 amounted to over EUR 730 m. Import is estimated at EUR 575 m. This allowed for the foreign trade surplus in agricultural trade to be sustained. The greatest increase occurred in grain and oil-bearing crops, whose producers made utmost use of the subsidies granted under the support measures (for purchase of good quality seeds, fertilizers and fuel).

However, the situation with vegetable and fruit trade appears quite different, some items increasing and others decreasing. A positive trend consistent with the restructuring of some farms and processing companies is the higher export of dairy products and meat, as well as wines and tobaccos. Higher import of fruit and vegetables causes concern because national production obviously could not meet domestic demand (production and consumer), though providing certain export quantities. The reasons for this state of the sub-sectors could be sought in lower use of land (some 15 per cent down on 2003), and the extremely small share of green houses on that land (less than 1 per cent).

Fulfillment of commitments to the EU

Registration of agricultural producers. After negotiations for EU accession were finalized, preparation in the area of agriculture focused on registration of agricultural producers, problems with farm land use, and financial schemes for farmer support.

At present registered agricultural producers aproximate 65 thousand and based on the farm census taken in 2003 the number of farms with over 5 decares of land (potential market producers) is about 400 thousand. With the recently adopted Ordinance by the Board of MAF amending and supplementing Ordinance No. 3 of January 1999 on the creation and maintenance of a register of agricultural producers, the practice of multiple registration of agricultural producers within a calendar year is discontinued. Amendments come into force as of 4 April 2005 and concern maintenance of the Register of Agricultural Producers, being part of an overall system for agricultural production administration in compliance with EU requirements.

National Dairy Board. Part of accession commitments are steps taken in relation to the establishment of a National Dairy Board – professional organization of producers, processors and merchants of dairy products. The purpose of the organization is development of production, processing and trade in milk and dairy products in compliance with European standards. Its task is to manage and control the origin, authenticity and quality of the products offered on the market, to introduce the principle of self-regulation by allocating and controlling production quotas, and subsidies granted. This would boost development of modern farms, consolidation of companies within the industry, bring to light the bulk of entrepreneurs and stimulate production of higher quality raw material. The Board must create and maintain registers of milk producers, milk collection points, milk processing enterprises, merchants of milk and dairy products, and accredited laboratories for quality assessment. The system of individual milk quotas is to be piloted as of 1 April 2006 and full commissioning is to be completed a year later.

Transition to another type of vaccination. In pursuance of another commitment a special National Program on termination of existing vaccination of pigs and its replacement by 1 January 2006 has been developed. As known, the EU does not permit application of live vaccine against the classic plague among pigs. The programme envisages a staged shift from the existing practice of live vaccine application toward marked vaccine used in the EU. By a decision of the MAF the scheme for transition from the old type to the new type of vaccination was altered. Studies and analyses made by veterinary experts show that in order to incur less economic losses in case of occurrence of the disease, vaccination with the live vaccine should continue for a period of 8 months (not 6 months, as initially planned) and in the next 4 months newly born animals must be vaccinated with the marked vaccine. Thus the risk of desease spread will be restricted.

State Fund "Agriculture"

The government approved a budget transfer of BGN 160 m to the *State Fund "Agriculture"* for 2005. Thus the total financial resources of the Fund will amount to BGN 257.5 m. This is the highest amount in its 10-year existence. Planned direct payments to agricultural producers under the extended scope of the two programs, Plant-growing and Livestock Breeding, amount to BGN 56.5 m for the entire 2005. Investment subsidies of BGN 8.5 m are added to these. The financial resources under short-term credit failities amount to BGN 12.5 m and funds for long-term investment loans total BGN 180 m.

State Fund Agriculture announced allocation of financial resources under seven short-term target areas for 2005 as well as for export subsidies and a pilot scheme for testing the measure in support of less developed regions in Bulgaria. The seven target subsidies will provide funds for: (i) purchase of certified seeds of black oil-bearing sunflower, (ii) maize, (iii) spring barley, (iv) purchase of mineral fertilizers for the spring sowing, (v) purchase of potato planting material for seed production and consumption, (vi) support to feeding and selection of animals and birds from the national genetic fund, and (vii) reclamation of unused private farm land.

The new pilot scheme for compensatory payments to agricultural producers in less developed regions is of great interest for farmers. Initially included are the municipalities of Balchik, Boliarovo, Varshets, Kotel, Malko Tarnovo and Chuprene. All producers (individuals and legal entities, sole traders and co-operatives), registered as carrying out agricultural business on the territory of these municipalities, may apply for compensatory payments. Annual basic payment under this scheme amouns to BGN 30 per decare (BGN 300 per hectare). Additional payments are envisaged for young agricultural producers (BGN 20 per hectare) and for members of organizations of agricultural producers (BGN 40 per hectare). Application of the pilot scheme for compensatory payments will bring State Fund Agriculture closer to establishment of a payment agency in Bulgaria, which will allocate funds for agriculture after accession to EU. The intention of the government is for the payment agency to be put in place by the end of the year.

SAPARD Programme

The EU special accession programme for agriculture and rural development in the period of pre-accession of candidate countries, including Bulgaria (SAPARD)[43], played a very positive role for structural adjustment in agriculture. Many producers still rely on it for successful entry in the single European market. So far over 1,900 projects have been approved totalling over BGN 1.5 b against a total subsidy of BGN 744 m. 100 per cent of allocated funds under the Programme for the period 2000-2003 have been utilized and 98 per cent for 2004. Efforts for negotiating additional funds under the financing agreement for 2004 continue, and the funds would be at the expense of the agreements for 2006 and 2007. According to MAF estimates, at least EUR 100 m in additional funds is needed in total for all measures under the 2004 programme and another EUR 100 m is needed for the next two years so that successful work on it could continue. The funds allocated so far are not sufficient for the financing of already approved projects. Granting of additional funds under SAPARD Programme would be a precedent in the history and practice of the Programme but a number of European experts assess its current implementation as very successful and the need to modernize significant number of processing enterprises and more efficient organization of production is apparent. It is expected that motivated requests on the Bulgarian side will be accepted by the European Commission and the financing agreement for 2004 will be ratified together with the additional funds so that acceptance of new projects under the Programme could resume.

Granting of allocated funds under measure 07 (for renovation and development of villages) and measure 08 (development and imrovement of rural infrastructure) started last year. Given difficulties faced by municipalities in ensuring own funds for co-financing of projects under these measures, State Fund Agriculture will extend interest-free loans effective as of 1 April 2005. The loan amount may not exceed the value of approved investment costs associated with development of rural infrustructure projects (roads, sewerage, other water supply and sewerage facilities). The interest-free loan funds may not be used for other purposes. 47 municipalities which have approved projects under SAPARD and concluded agreements with the Fund would be able to make use of such loans. These are mainly municipalities in less developed rural areas whose budgets do not provide funds for such projects.

[43] http://www.mzgar.government.bg/Sapard/Documents.htm

2004 brought several new developments in the area of regional policy, which to a large degree lay down the priorities in this field for years to come. The announcement of the financial framework for Bulgaria for the three-year transitional period 2007-2009[44], the closing of the "Regional Policy" Chapter of the country's EU accession negotiations, and the adoption of the new Regional Development Act[45] pose very important challenges related to preparing the policy papers that will be at the base of funds absorption under the EU Cohesion and Structural funds.

Preparation of strategic and programmatic documents

During the first months of 2005, active work continued on drafting the programmatic and planning documents on the basis of which EU funds will be absorbed.

In the first place, this is the development of the *National Development Plan* 2007-2013[46] (NDP) with the 6 pertaining operational programs. This is one of the most important documents on the basis of which EU structural and cohesion funds will be allocated and absorbed on project-based principles.

The plan includes *6 operational programs* outlining the key aspects of funds absorption. The six programs are in the following areas: competitiveness of the Bulgarian economy, human resources, agriculture and rural regions, environment protection, transport infrastructure, and regional development. During the first months of 2005, six workgroups consisting of experts from the respective ministries and representatives of non-governmental organizations, developed the analytical part of the operational programs – socio-economic and SWOT[47] analysis.

The technology of drafting the operational programs envisages that the priorities and measures for their implementation will be developed later on the bases of the strengths and weaknesses and opportunities and threats outlined in the analysis. Thus they will establish the framework to justify specific development projects.

The approach towards the development of the NDP and its operational programs foresees the organization of *forums* at which all workgroups will participate together as representatives of the wider society. The goal is to discuss jointly documents drafted by each group and find the "crossing points" between them, thus avoiding the duplication of measures that would entail difficulties in financing. The first similar forum that brought together experts from workgroups and representatives of political parties, trade union organizations, the academic community, and non-governmental organizations was held in March.

At the next stage, each operational program's key priorities and implementation measures will be developed. Two more extended forums will be held to discuss the prepared operational programs and their wider promotion. The idea is to reach a consensus on the key aspects in the development of the country, as well as the widest possible public support. According to these plans, the entire process of preparation of the NDP and its pertaining operational programs should be completed before the end of the year or, at the latest, during the first months of next year.

Work on drafting the *regional development and design strategies and schemes* (NUTS 3 level) and of *municipal development plans* (NUTS 4 level 4) is still continuing.

Municipal development plans are expected to be ready shortly (for example, Varna Municipality announced its intention to present the finished plan at the end of April). Proposals included in the plans must comply with the key priorities of municipalities and the regional development strategies. Within the measures indicated in the plans, projects will be selected for support and implementation.

There are also plans to develop pilot integrated schemes and cluster approach models in the development of municipalities. Currently, the process of preparing the regional development plans (NUTS level 2 level) is facing some difficulties.

Institutional capacity building for project development and absorption of funds allocated under the Cohesion and Structural funds of the EU.

According to the new EU regulations, 78.5 per cent of the EU's financial resources, or EUR 264 b, is allocated to Structural funds. They should be invested to support growth and job creation in the least developed EU Member States. About 67 per cent of these resources will be allocated to regions with GDP under 75 per cent of the EU average, signifying about EUR 177 b. Bulgaria falls within this category. 23.8 per cent of EU resources are earmarked for the Cohesion Fund, which means EUR 13.2 b. These funds are intended for European territorial co-operation, and this fund will replace currently existing instruments - the PHARE and ISPA Programs.

Alongside programmatic documents, Bulgaria also needs institutional capacity building for the successful implementation and absorption of resources under the Cohesion and Structural Funds of the EU. The country still lacks capacity in this respect. The adoption of operational programs will provide an opportunity to absorb financial resources under specific

[44] The financial framework for Bulgaria for the three-year transitional period 2007-2009 will be EUR 4.245 b (EUR 2.3 b will be spent on structural policy).

[45] Promulgated OG, issue 14 of 20 February 2004

[46] The socio-economic analysis accompanying the plan was developed and submitted last year by the Economic Analyses and Prognosis Agency.

[47] Outlining the strengths, opportunities and risks for development in a given sphere.

projects. These projects however must be adequately prepared and then submitted for support. Provided it is prepared for this, even during the first three years of EU membership Bulgaria could absorb EUR 2.3 b.

During the past year, Bulgaria worked on training municipal and regional administrations to build absorption capacity and prepare them for the EU Structural and Cohesion Fund. The leading function of organizing and providing the training was entrusted to the Ministry of Regional Development and Public Works (MRDPW). For this purpose, in early 2005 a project was launched under the joint initiative of the MRDPW and the UN Development Program. The goal is to improve the potential of local administrations *for strategic planning* and in particular for developing municipal, regional (NUTS 3), and planning region (NUTS 2) plans – the key instruments of regional development. This training is in line with the country's commitments under chapter 21 "Regional Policy" of EU negotiations.

The first stage of the training process under the project was implemented in March in Varna and dealt with the preparation of plans and development projects for the Northeast planning region. This joint initiative of the MRDPW and UNDP is a pilot for the country. There are plans to expand its scope to the remaining five planning regions. Substantial support in strategic planning will be provided by the planned development of a *Universal Program* (Manual) for project planning and preparation. It will involve assistance in developing regional strategies and municipal development plans, with emphasis on exchange of experience and successful practices in various municipalities.

The project and training activities are targeted at regional and municipal administrations, as well as at Regional Development Councils.[48]. There are plans for representatives of non-governmental organizations, the business community, social workers, and cultural institutions also to be engaged in the training process.

With the completion of Stage One, training on the *development of specific projects* will start.

Changes in the regulatory framework

In early April the National Assembly adopted on second reading *changes to the Regional Development Act* on its part in establishing the "target regions".

According to the law, areas are divided into: areas of economic growth, areas of industrial decline, and underdeveloped areas (border, rural, mountainous). This classification is stipulated in the Regional Development Act[49] according to the following criteria: (1) economic development and structure of economy, (2) employment and unemployment, (3) transport and infrastructure, (4) development potential, and (5) geographical location. These criteria will serve as the basis of decisions to channel investment to certain regions for the purpose of overcoming disparities more quickly and, in the long run, moving closer to EU standards.

The *areas of economic growth* will include municipalities with well-developed infrastructure and business. The class of *areas in industrial decline* will consist of municipalities where the restructuring of industrial structurally significant enterprises took place or is still taking place, thus resulting in lower production levels and higher unemployment. The group of *underdeveloped border areas* will include municipalities in which part of the administrative border coincides with the state border. The category of *underdeveloped rural areas* will include municipalities where over 20 per cent of workers are employed in agriculture and forestry. The definition of *underdeveloped mountainous areas* covers municipalities located over 500 m above sea level.

Under the previously applied regulations, 43 of a total of 263 municipalities did not match the criteria for "target regions". Following the amendments to the law, only about a dozen municipalities do not fall within this category. All others will have the right and the opportunity to benefit from "targeted impact" funds provided by both the national budget and by EU funds.

The benefits of *legally* defining the targeted impact regions and the relevant criteria arise from the opportunity to avoid the subjectivity of assessment that used to be an existing risk under the repealed Ordinance.

New approach in regional development - clusters

The formation of *clusters* is one of the efficient regional development instruments to achieve economic growth and reduce the disparities between individual areas.

This practice is widely used in a number of EU countries and is yielding good results. For Bulgaria this is a relatively new instrument that has been gaining speed over the past years.

The creation of clusters is in line with the EU policy of convergence between countries and regions and is of particular significance for regions of unexploited economic and labor potential. This approach is directly related to regional policy, reducing disparities, and the full use of the capacity of economically underdeveloped areas. Several conditions need to be met at the regional level: ensuring appropriate infrastructure (incl. transport, telecommunication, energy) and human capital development. Also important are the adequate functioning of institutions and enhancing the capacity of local administrations.

[48] See Regulations on the organization and functions of Region Development Councils (NUTS 2), promulgated in iss.. 79 of the OG of 10 September 2004

[49] Until now they were established by virtue of an Ordinance.

Establishing an adequate infrastructure for *innovation development* (wide use of information and communication technology) is of particular importance to the prosperity and improved competitiveness of regional economies.

"Clusters" is a new term for countries in transition and only recently became the subject of analyses and comments. A cluster is a geographic and economic concentration of interrelated companies, specialized product and service providers, and associated institutions, incl. those engaged in R&D, typical of a given region or country. Clusters develop because they lead to increased productivity and hence increased competitiveness of participating companies. An environment of cooperation between companies is at the heart of a competitive cluster.

In *Bulgaria* the unification especially of small and medium-sized enterprises in interrelated production networks became particularly popular during the second half of last year and the beginning of this year. The key drivers for cooperation are the striving for better solutions to common problems, the facilitation of marketing or business strategies, better networks of trading outlets, simpler logistics, and more opportunities for innovative solutions.

Various branches of industry and regions in the country formed the following clusters:

- cluster Sevlievo – core production/producer plus developing related additional activities;
- cluster Rousse/clothing - similar production in a number of SMEs – association for providing the necessary services, markets, marketing, supplies;
- cluster Devnya – a group of core production enterprises sharing the same problems (mostly environmental and infrastructure);
- cluster Srednogorie/copper - a group of companies from the same industry to establish the necessary infrastructure and organize the provision of relevant services;
- cluster Dobrich/shoes – currently there are about 20 companies that sprang up on the foundation of the former state-owned factory (now out of business) that meet all the necessary preconditions for establishing a cluster etc.

One of the latest clusters to be formed in the country is the cluster named Bulgaria's Energy Heart in the East Maritsa basin. The Agreement for its establishment was signed on 22 March 2005 by over 30 founding members.

Cluster formation in Bulgaria is encouraged under the *PHARE Program*. Clusters in the country will receive support worth about EUR 1 m under two PHARE projects. One of them, worth EUR 800 thousand, will be a pilot project to establish two tie-ins and finance consultant services for their implementation. The second project is worth EUR 250 thousand and its implementation will start before the end of this year. 15 clusters will receive support as part of this second project.

PHARE financing will also be used to develop a *National Strategy for Support of Clusters*.

Fiscal decentralization

An event of major significance for developments in the field of fiscal decentralizations was the conference held in early March under a CED-implemented project "Fiscal Decentralization in Bulgaria: the Next Steps – Increasing The Autonomy Of Local Governments " with financial support from *LGI/OSI*[50].

The project pursued the following goals: (1) continue the debate on fiscal decentralization, (2) define the most up-to-date topics of discussion, (3) provide support to government and municipal authorities in the introduction of good practices, (4) provide cooperation in overcoming the differences between stakeholders, and (5) establish horizontal and vertical coordination in the process of fiscal decentralization.

The conference provided an overview on expanding the financial authority of local government in Bulgaria: the key issues, recommendations, and future implementation measures were outlined.

According to experts *the problems* of fiscal decentralization arise from flaws in the current legislation, severely restricted sources of municipal revenues, the need to further streamline municipalities' spending, and insufficient municipal investments.

Some of the key *proposals* envisage:

- Changes in legislation - above all, in the Constitution, allowing municipalities to establish and administer local taxes and charges; giving tax autonomy to local government in respect of local taxes and charges; placing under the control of local government additional taxes (local business tax, farming land tax etc.).
- Expanded revenue base -providing local government with opportunities to encourage economic activity by granting certain economic agents tax-exempt status for certain local taxes; increase the collection rate for local tax revenues; update local charges depending on the investment and cost involved.
- Streamlined spending - include an investment component in the standards for delegated activities; participation of the private sector in the provision of public services public-private partnership for the purpose of more efficient management of municipal property.

[50] The Local Government and Public Service Reform Initiative of the Open Society Institute, Budapest works on issues related to "financial decentralization, financial management, and budgeting".

- Sustainability of municipal budgets - comprehensive asset management by calculating the rate of return from the revenues they generate minus the maintenance cost; strengthen the cooperation and collaborative efforts of municipalities in developing joint projects for financing from international funds and programs.

Absorption of pre-accession funds

PHARE Program. In March the Ministry of Economy presented a project under the PHARE Program *"Support for Increasing the Competitiveness of Bulgarian Enterprises"*. The goal is to clarify the procedures and necessary documents for support under this project; it will be launched in about six months and will be completed in 2009. Grants of EUR 30 million will be awarded, with part of the funds provided by the state. Eligible projects will involve the introduction of quality management systems, workplace safety standards, installations for environmental protection, innovative solutions and good production practices. Expectations are that company strategies and operations will be improved, having a positive impact on the competitive position of enterprises.

Projects will be evaluated and selected based on the following criteria: (1) resources assessment, (2) detailed description of costs, (3) total economic effect of project implementation, (4) use of new technology or new products, (5) introduction of information systems, and (6) overall improvement of the enterprise's competitiveness.

The PHARE Program will also support projects for *technological transfer* (know-how dissemination). 14 Technological Transfer offices are expected to be established in the country.

PHARE Program "Cross Border Cooperation". In March a Financial Memorandum was announced between the EU and Bulgaria for EUR 28 m in grant money under the PHARE Program for cross border cooperation with Greece and Romania. From the total amount, EUR 20 m are intended to support co-operation with Greece while the remaining 8 m - will finance partner projects with Romania.

Funds will be used for projects to improve the transport infrastructure, environmental protection, development of cultural, tourist, and human resources, as well as enhancing the economic activity and cross-border contacts at the local level through a joint Small Projects Fund People-To-People.

SAPARD Program In March the government published the draft for an annual Financial Memorandum between Bulgaria and the European Commission, according to which the country will receive a EUR 67.56 m grant under the SAPARD Program[51].

The program goal is to support the integration of the Bulgarian agricultural policy to that of the EU and to assist in addressing the issues of priority in the area of agriculture and rural development.

Some good practices in local government

Control on Public Procurement. In early 2005, Varna Municipality established a specialized *office for control on public procurement* (operational since 2 March). Such practices are provided for under the Public Procurement Act (PPA). The new structure is subordinated to the "Investment Policy" Directorate. The creation of a structure of this type was necessitated because of the following typical reasons: (1) problems related to violations in procurement procedures, (2) failure to keep deadlines, (3) lack of adequate technical and other resources to deliver the procurement on the part of winning bidders (for example in the case of renovation of the street lighting in a municipality in which the company that was ranked first in the bidding turned out not to be technically equipped to carry through with the procurement), and (4) lack of strict controls.

The functions of the new unit include preparation and monitoring of PPA procedures. Until now this activity was scattered between individual directorates. The new structure will provide an opportunity for better control on the way rules are observed, the quality of implementation of public procurement deals, and maintaining of deadlines and schedules by procuring companies.

This is a good practice that could be taken over by other municipalities in the country in order to ensure the better quality of public procurement.

Public Internet portal. Another example of a good governance practice in Varna Municipality is the decision to launch a *Public Internet portal*. The portal will provide information on regulatory regimes, transport, tourism, trade, administration, and education. The portal will combine the entire information flow and make it more accessible for citizens and businesses. In this way the process of communication between businesses, citizens, and the municipal administration is expected to improve considerably; the communication flow will be faster and more effective while providing lower corruption potential.

Other tools to improve communication foresee establishing wireless Internet access on the territory of the municipality and installing pavilions providing 24-hour access to the Internet Portal.

The project is estimated to be worth about BGN 2.5 m. This is one of the best opportunities to modernize local administrations and requires considerable financial and human resources. Opportunities will also be sought to obtain financial support from EU funds.

[51] Up until the present moment Bulgaria has signed grant agreements under the SAPARD Program worth EUR 219 m.

The last two pre-accession years are of enormous significance for the country's preparedness to conduct an efficient regional policy. This would require good strategic planning, improving the project development capacity to absorb European funds, providing greater autonomy to local government in economic development, and applying good practices in local self-government. Practice shows that such processes are gaining speed. Nevertheless, serious efforts are to be applied in respect to strategic planning and to the preparedness of local administrations in improving their qualification, as well as benchmarking, and expanding public-private partnerships.

The latest legislative amendments are marked by the forthcoming accession of Bulgaria to the European Union and by the need to ensure the prevalence of European law over national law, which is a fundamental Community principle laid down in its basic instruments. Significant amendments to Bulgarian legislation concern: (1) statute of ownership , (2) concessions, (3) amount of minimum wage in Bulgaria, (4) banking sector, (5) insurance, (6) energy efficiency, and (7) water supply.

Constitutional Amendments

The approved second amendment to the democratic Constitution of the Republic of Bulgaria, which was promulgated in Official Gazette, No. 18/25 February 2005, is undoubtedly the most important legislative amendment. It was voted on the basis of a wide political consensus of the parliament-represented political forces, which was dictated by the new realities connected with the forthcoming accession of the Republic of Bulgaria to the European Union and by the resulting delegation of some part of the national sovereignty to the Community institutions. The amendments brought the basic instrument in line with the basic instruments of the Union and with the European Constitution which is pending for ratification. Thereby Bulgaria will be able to constitutionally sign the accession treaty while observing Article 85, paragraph 4 of the Constitution. Generally speaking, according to this article any international treaty containing provisions in contravention to the Constitution should be signed after making the respective amendment to the Constitution to bring it in compliance with such international treaty.

There are six basic lines of amendments to the Constitution:

- Delegating partial powers to the European Union and its bodies;
- Specifying the parliamentary majority for ratification of the Accession Treaty;
- Developing new constitutional arrangements of land ownership;
- Providing an opportunity for extradition of Bulgarian nationals;
- Expanding the active and passive electoral rights for Bulgarian nationals and for European nationals with permanent residence in Bulgaria;
- Regulating the relations between the Council of Ministers and the National Assembly in developing national positions with respect to Bulgaria's EU membership.

We will dwell hereunder on the most important amendment to the Constitution, which became subject of vigorous public debate and disputes in the Parliament – granting foreign individuals and foreign legal entities from the EU the right to acquire title over land, including agricultural land, after the signing and in accordance with the provisions of the Accession Treaty.

The new text of Article 22 (as amended, OG, No. 18/2005, in effect from the enforcement date of the Treaty on Republic of Bulgaria's Accession to the European Union, and not applicable to status quo international treaties) reads:

"(1) Foreign individuals and foreign legal entities may acquire title over land under the terms and procedures resulting from Republic of Bulgaria's accession to the European Union or on the strength of international treaties which have been ratified and have taken effect for the Republic of Bulgaria, as well as through hereditary succession.
(2) The act on the ratification of international treaties referred to in paragraph one shall be passed with a majority of two thirds of all MPs.
(3) The statute of land shall be determined by law."

This amendment to Article 22 of the Constitution was dictated by the commitments of Bulgaria under the Accession Treaty to ensure free movement of people and capital among the EU Member States.

Before the above amendments foreign individuals and foreign legal entities were prohibited to acquire title over land except in case of hereditary succession. Foreign individuals and foreign legal entities bought land by way of participation in joint ventures. Foreign individuals could hold only title over buildings and limited property rights over real estate (building title, right of use, servitudes).

The new provision enables the legislator to grant title over land to third-country (outside the European Union) nationals and legal entities on the basis of ratified international treaties.

The liberalized regime of acquisition of land by foreign individuals was strongly criticized by the parliamentary opposition but enjoyed full support by all right-wing political forces represented in the Parliament. Right-wingers defended the opinion that the amendment had been dictated by the European integration of Bulgaria and had made it possible to sign the Accession Treaty.

Coalition for Bulgaria sharply criticized the amendment to Article 22 of the Constitution because in their opinion foreign individuals would be able to purchase Bulgarian land without any control and at low prices, which would lead to loss of some of our national identity. The left-wing parliamentary opposition was mainly against the provision enabling nationals from third countries outside the EU to acquire land in Bulgaria by virtue of international treaties ratified by the Republic of Bulgaria. Given that the ratification of international treaties by the National Assembly is an act ensuring protection of the national interests, the fears of Coalition for Bulgaria are mostly inspired by the fact that on the force of the provisions of international private law, the statute of foreign investments concerning the right of third countries' nationals to purchase Bulgarian land will be applied *not only with respect to the treaties ratified* ***after*** *the amendment to the Constitution,* but also to over fifty effective agreements for mutual encouragement and protection of investments, only 20 of which are with EU countries, which the National Assembly ratified at a time when another land regime was effective.

Despite the severe criticism by the public and the parliamentary opposition, which is more or less reasonable, we could make the conclusion that the amendment to Article 22 of the Constitution was inevitable; it did not only bring Bulgarian constitutional regulations in line with the EU Treaty as a condition for Bulgaria's EU membership, but it is also a precondition for a functioning land market, based on equality of all citizens.

Concessions

Two important instruments regarding concessions have been adopted and promulgated – Governmental Decision to grant under concession Trakia Highway for a period of 35 years without tender or competition, with two subsequent amendments, as well as Amendments to the Regulations on the Implementation of the Concessions Act.

The concession of Trakia Highway is granted under CoM's Decision No. 1043/30 December 2004 for concession of national road Kalotina – Sofia ring (North arc) – Orizovo – Stara Zagora – Nova Zagora – Jambol – Karnobat – Bourgas, constituting exclusive state property, which was promulgated in OG, No. 5/14 January 2005. It was amended by two subsequent governmental decisions concerning, on the whole, the procedure of signing the concession agreement and its coming into effect:

Decision No. 88/11 February 2005 on amendment to Governmental Decision No 1043/2004, promulgated, OG, No. 15/15 February 2005. According to the single text of the decision, the concession agreement had to be signed within one month following promulgation of the decision in the Official Gazette, i.e. by 15 March 2005.

Decision No. 190/15 March 2005 on amendment to Governmental Decision No.1043/2004, promulgated, OG, No. 23/2005. According to the decision the concession agreement was to be signed by 1 April 2005. The concession agreement for Trakia Highway was signed on 29 March 2005 by the Minister of Regional Development and Public Works Mr. Valentin Tzerovksi and the Bulgarian-Portuguese consortium "Trakia Highway" Jsc. The agreement shall take effect as of the date on which the following conditions are cumulatively satisfied:

(1) coming into effect of a decision of the Competition Protection Commission (CPC) under correspondence No. CPC – 344/2004, confirming that the concession procedure for Trakia Highway does not involve inadmissible state aid;

(2) positive opinion from Eurostat to the effect that investments are reflected in the balance-sheet of the concessionary;

(3) written consent of the European Investment Bank to have the sections Orizovo – Stara Zagora and Karnobat – Bourgas, which are to be completed by yearend, included in the concession.

Despite, there are still doubts as to the partner selection transparency and the transaction profitability. An interim inquiry commission has been set up with the task to investigate the extent of compliance of the concession agreement with national interests. The mandate of the commission was extended because the transaction documents had been secretive until recently. The compliance of the deal with law is not disputable, because §3b from the Transitional and Final Provisions of the Concessions Act provides the power of the State to grant concessions without holding of tender or competition procedures to joint ventures with state participation, as the concessionary under the referred concession agreement – the Bulgarian – Portuguese consortium "Trakia Highway" Jsc.

The second important instrument regarding concessions relates to the Regulations on the Implementation of the Concessions Act, adopted by CoM's Decree No. 240/13 December 1995, as amended, No. 10/28 January 2005.

New paragraph 2 and paragraph 3 are added to Article 25, eliminating the absolute prohibition for competition commission members to disclose materials and make statements in the media, and specifying the persons, who are allowed to give information regarding the transaction, as well as the type of such information. According to Article 25, paragraph 2, only the respective minister or the chairman of the competition commission is allowed to make statements on the process during the competition or tender procedure. Statements may relate to applicant's name and to other facts entered in the Commercial Register under applicant's file, as well as to that part of applicant's proposal, which does not represent a business plan or other information, which the applicant has expressly declared to be trade secret. Many acts contain provisions as to the facts representing trade secret. The legal definition of the term "trade secret" is contained in the Act on Protection of Competition (APC), § 1, item 7 of the Additional Provisions: "business-related facts, information, decisions and data, which the rightful persons deem it in their interests to keep secret and have taken due measures to do so." All bodies and officials are obligated not to disclose facts about traders, which represent business secret and have become known to them in the course of work.

In exercising the right of the candidate concessionaries under Article 25, paragraphs 2 and 3 of the Regulations on the

Implementation of the Concessions Act to specify by themselves the facts representing trade secret, they could declare unduly large number of facts to be undisclosable. Thereby the attempt of the new supplements to the Regulations to induce some transparency in the tender and competition procedures could prove totally unsuccessful.

Social Security and Labor Law

Three regulations concerning largely the status of workers and employees in the changing economic environment and labor market have been adopted in the insurance and labor law field. These amendments relate to the procedure of paying compensations to the workers and employees in the event of bankruptcy of their employer, to the minimum wage amount for Bulgaria, to pensions, and to the length of service for social security purposes.

With a view to protecting workers and employees' rights and interests in the event of bankruptcy of the commercial company employing them, a Regulation on the terms and procedure of informing workers and employees and on allowing and paying guaranteed receivables in the event of employer's bankruptcy was developed and adopted by Government Decree No. 362/29 December 2004, promulgated in Official Gazette, No. 3/11 January 2005, in effect on 1 January 2005, on the grounds of Article 29 of the Act on Guaranteeing the Receivables of Workers and Employees in the Event of Bankruptcy of their Employer.

According to the Regulation, the guaranteed receivables are payable by the corresponding regional department of the National Social Security Institute (NSSI's RD) at employer's registration on the basis of an order by the director of the Guaranteed Receivables of Employees Fund. Within 3 days following promulgation of the court decision for opening of bankruptcy procedure in the Official Gazette, the employer is obligated to inform the employees about the promulgation date and the procedure of payment of the guaranteed receivables pursuant to the Act on Guaranteeing the Receivables of Workers and Employees in the Event of Bankruptcy of their Employer. The guaranteed receivables are paid on the basis of an application and declaration form submitted by the worker or employee to NSSI's RD at the employer's registration within 30 days following the promulgation date of the decision to initiate bankruptcy procedure.

Regarding the minimum wage amount, CoM's Decree No. 12/21 January 2005 on specifying new level of the minimum wage for Bulgaria was adopted and promulgated in Official Gazette, No. 10/28 January 2005. On the basis of the regulation, as of 1 January 2005 the new level of the minimum monthly wage for Bulgaria is BGN 150 and the minimum hourly rate – BGN 0.89, with minimum 8 working hours per day and 5 working days per week.

Governmental Decree No. 39/11 March 2005 amending the Regulation on pensions and length of service for social security purposes approved by Governmental Decree No. 30/2000 has been adopted in the pension insurance field. New paragraphs 15 and 16 are inserted in Article 38 of the Regulation on pensions and length of service for social security purposes. According to paragraph 15, as of January 2005 overtime is counted as length of service for social security purposes. According to the Labor Code, overtime is any work done by the worker or employee by order of or with the consent and no opposition of the employer or the corresponding chief outside the established working hours for such worker or employee. Overtime is prohibited. Overtime is only allowed as an exception in the cases referred to in the Labor Code.

Banks and Finance

Given the large number and growing total amount of bank loans, which raised concerns about banking sector's stability, BNB imposed some restrictions on commercial banks' operations. Since the beginning of the year BNB has approved a couple of regulations in the field, most important of which is the Regulation amending BNB's Regulation No 21/1998 on the minimum required reserves maintained with the Bulgarian National Bank by banks, promulgated, OG, No. 20/2005. New paragraph 1 is inserted in article 9 of the Regulation. According to this paragraph, besides the reserves referred to in article 8, banks shall maintain with BNB additional minimum required reserves in case of increased total amount of granted loans.

Insurance

With a view to improving the regulatory framework of insurance and guaranteeing insured persons' rights, and given the higher frequency of abuse by insurers, the Financial Supervision Commission approved by Decision No. 79/15 February 2005, promulgated, OG, No. 20/2005, Rules on the Structure and Activities of the Guarantee Fund set up pursuant to article 93, paragraph 1 of the Insurance Act.

According to the Rules, the fund is a legal entity with a scope of business including payment of compensations under compulsory insurance pursuant to article 77, paragraph 1, items 1 and 2 of the Insurance Act in the cases referred to in the Act. The Fund pays compensations:

1. under mandatory Third Party`s Liability insurance:
   a) for non-material damages, where the harm-doer cannot be established;
   б) for non-material and material damages, where the harm-doer is not insured or is not a licensed driver;
2. under mandatory Accident insurance, where the carrier is not insured.

Buildings Rehabilitation

With view to the increasing need of rehabilitation of panel-construction buildings due to their poor condition, and in connection with the requirement for electricity and thermal energy savings, a number of energy efficiency laws and regulations were adopted in recent times. A new regulation relating to the new requirement for certification of existing and new buildings was adopted in early 2005 – Regulation No. 20/12 November 2004 of the Minister of Energy and Energy Resources on the terms and procedure of registering persons carrying out certification of buildings and energy efficiency inspection, and on the terms and procedure of obtaining information, promulgated OG, No. 5/14 January 2005, in effect on 14 January 2005.

According to the ordinance, the Energy Efficiency Agency shall keep separate public registers of persons carrying out certification of buildings and of persons carrying out energy efficiency inspection. Such persons shall meet the requirements for the corresponding type of activity, referred to in the Energy Efficiency Act.

Water Supply and Sewerage

Two new acts were adopted in recognition of the increasing importance of the WSS sector for the Bulgarian economy – Act on the Regulation of Water Supply and Sewerage Services, promulgated, OG, No. 18/25 February 2005, in effect as of 20 January 2005, and Law on amendments to the Waters Act, promulgated, OG, No. 18/25 February 2005, in effect on 20 January 2005.

The Act on the Regulation of Water Supply and Sewerage Services establishes the administration of prices, affordability and quality of water supply and sewerage services provided by water supply and sewerage operating companies. The water supply and sewerage services are regulated by the State Energy and Water Regulatory Commission set up pursuant to the Energy Act, which replaced the State Energy Regulatory Commission.

The amendments and supplements to the Waters Act assign to the National Assembly as the supreme legislative body the task to develop the overall WSS sector development strategy. Thus the new text of article 151, paragraph 1 of WA reads: “The National Assembly shall adopt a National Water Sector Management and Development Strategy setting the basic water sector development goals, stages, mechanisms and methods.”

THE BULGARIAN CAPITAL MARKET: STRATEGIC CHALLENGES

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The beginning of 2005 will be probably defined some time in the future as a turning point for the Bulgarian capital market. The successful sale via BSE-Sofia of the residual state-owned interest of BTC presents an important step for the development and growth of the capital market, and it is expected to have a long lasting positive effect. With this privatization and with the transformation of BTC into a public company, the stock exchange registered considerable increase of capitalization, turnover, liquidity, and volume of trading. The success of the auctions held for the sale of the residual interest of BTC is not only the most telling example so far of successful stock exchange privatization, but also proof of the potential of the stock exchange. This privatization deal provides a new and very serious argument for the attraction onto BSE-Sofia of other remaining key privatization deals.

However, though significantly changed after January 2005, the Bulgarian capital market remains marked with many shortcomings and needs active measures to overcome the strategic challenges facing its development.

Significance of the capital market in Bulgaria

On the one hand, the significance of the capital market within the financial system of Bulgaria follows some generally valid characteristics for the countries of Central and Eastern Europe. These countries (some of them already members of the EU) just over a decade ago did not practically have a financial sector in shape or form similar to those of developed economies. Even today, the "depth" of the financial sector in the most advanced countries of the region remains several times below that of the 15 EU Member States.

On the other hand, what is characteristic of Bulgaria is that even with such a low base in regional terms, the share of the capital market in particular is rather small in the country. Table 14 shows the current picture of the position of the capital market in the financial intermediation in Bulgaria.

Table 14. Degree of financial intermediation, % of GDP at period end

	2001	2002	2003	2004[2]
Banking system assets	41.13	45.02	50.34	65.51
Net assets of funds managed by pension insurance companies[1]	0.63	1.03	1.48	1.79
Gross premium income of insurance companies[1]	1.61	1.91	1.94	1.44
Total market capitalization of BSE-Sofia	3.72	4.25	7.91	10.60

(1) Data for 2004 are as of end September
(2) According to annual GDP estimates, source AEAF[52].

Source: BNB, FSC, BSE-Sofia and own calculations

The table clearly indicates that the banking system dominates the financial sector in Bulgaria and that the relative size of the capital market (measured through the ratio of total exchange capitalization to GDP) is small. It is worth emphasizing here that formal indicators of market capitalization of companies traded on BSE-Sofia overestimate reality, as the actual free volume (so-called free float) of traded issues is smaller as a percentage of capital.

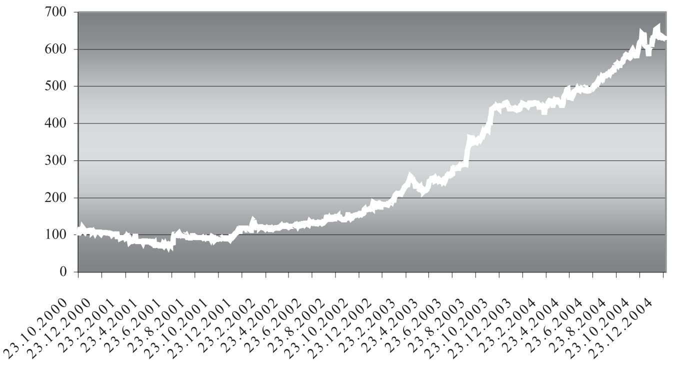
Therefore, a general conclusion can be drawn that the capital market remains less popular as an alternative channel of financial intermediation in the country. The development of the Bulgarian financial system remains "distorted" mainly in favor of the banking sector. These observations are confirmed by specific quantitative and qualitative surveys of the condition of the capital market in Bulgaria.

General quantitative characteristics of the revival

The capital market in our country is traditionally identified with the BSE-Sofia, and the popular measures of market developments are the indicators related to stock exchange trading. Thus, assessments of the condition of the capital market usually start with the finding that predominantly positive trends have been observed in recent years. This is initially seen in the movements of SOFIX stock exchange index. Following 2001, the index established an upward trend (Figure 22).

[52] "Short-term projections for Bulgarian economy", October 2004.

Figure 22. SOFIX movements (23 October 2000 – 29 December 2004)



The upward development of stock exchange trade is also proven by some of the most important summarized indicators (turnover, volume, liquidity, and market capitalization, Table 15).

However, despite the formal indicators of positive development thus far, and also despite the prevailing positive expectations of immediate prospects, an in-depth analysis of Table 14 data gives grounds for contradictory assessments. Stock markets are leading with regard to annual turnover and capitalization, although annual growth rates are definitely not higher than those of bonds. Stock markets clearly reflect the trend of the "writing-off" of public companies from the capital market. The number of various bond issues registered on BSE-Sofia has been growing over the years, but remains far below the number of registered issues of shares. Liquidity indicator for bonds markets should also be assessed prudently by taking into consideration the infrequency of bonds transactions.

Table 15. Indicators of BSE-Sofia trading

	2000	2001	% growth rate 2001/2000	2002	% growth rate 2002/2001	2003	% growth rate 2003/2002	2004	% growth rate 2004/2003
Bonds market, total[1]									
Number of issues at period end	3	8	167	11	38	20	82	29	45
Annual turnover (BGN m)	3.34	1.09	-67	19.52	1691	68.64	252	87.01	27
Total nominal value at period end (BGN m)	4.08	22.52	452	61.67	174	185.58	201	316.69	71
Liquidity[2]	82	5	-	32	-	37	-	27	-
Bonds market, total[3]									
Number of issues at period end	524	402	-23	356	-11	338	-5	333	-1
Annual turnover (BGN m)[6]	123.6	155.32	26	316.89	104	275.05	-13	869.85	216
Capitalization at period end (BGN m)[5]	1287	1112.57	-14	1375.18	24	2728.74	98	4033.2	48
Liquidity[4]	10	14	-	23	-	10	-	22	-
Other									
Block deals (annual turnover BGN m)	91.7	114.49	25	244.7	114	151.17	-38	247.41	64
Privatization deals (annual turnover BGN m)	6.76	3.87	-43	2.89	-25	16.49	471	14.68	-11
Privatization deals in non-monetary payment instruments (annual turnover BGN m)	0	0	-	0.3	-	284.06	94587	14.98	-95

(1) Official market corporate bonds, OTC bonds market and Official market municipal bonds.
(2) Measured as a turnover /total nominal value ratio, %.
(3) Official and OTC shares market.
(4) Measured as a turnover /capitalization ratio, %.
(5) Investment companies excl.
(6) Block deals incl.

Source: BSE-Sofia and own calculations

The contradictory "qualitative" characteristics of the market

Assessments are contradictory also when reviewing additional statistical information on the markets of shares and bonds, block trading, stock exchange privatization, and the real investors' base. Assessments of the condition of the market can also be justified by observations of the "qualitative" nature. Such observations are the recently conducted sociological survey results of the attitudes towards the Bulgarian capital market.

At the end of 2004 Estat Agency for Sociological and Market Surveys conducted the most detailed sociological surveys in our country so far on the subject – some of these representative for the population and business in Bulgaria, and some focused on currently traded companies on the stock exchange, including a selected group of attractive potential issuers.

The findings of the sociological surveys about the condition of the market are conditionally assessed at three levels. Attitudes of citizens and businesses in general are on the lowest level. On the second, higher level, which can be conditionally referred to as the "practical" level, the assessment is made from the point of view of direct market participants – brokers, investment consultants, financial directors, analysts, etc. The third (highest, management) level is formed on the grounds of views of listed companies' managers and potential issuers on the development of the market and the respective business in a certain economic and regulatory environment. Such a division is necessary, since there exist apparent differences in the three types of assessments. Generally, these result on the one hand from their place in the hierarchy of each of the groups with regard to the market, and on the other – from the scales of decisions they make and responsibility they undertake.

Overall, the capital market is an area unfamiliar to Bulgarians. 67 per cent of the population today state they did not take part in the voucher privatization, and half of those who did, did not look for any further information. Each fourth citizen has never heard of the existence of BSE-Sofia. 2/3rds of the citizens are aware of it, but are not interested in its activities.

Even among business representatives, the total share of those who are interested in the stock exchange trading is minimum – hardly 5.6 per cent search regularly for information, and 68 per cent do not care at all. For 8 out of 10 companies, shares or bonds issues on the stock exchange are an unfamiliar method of financing.

It seems that the capital market in our country is popular mostly among certain circles – those of professionals and direct participants in the trading. Inadequate awareness of the public is among the reasons for the capital market not to be perceived as a real alternative for generating income or as a source of additional financing. Currently, the banking system is the most accessible source of funding for businesses and citizens. This is proven by the fact that 83 per cent of the companies that have borrowed financial resources over the last year have taken a bank loan. Only 2.4 per cent are those who secured funding through shares issue.

Due to the lack of information about the capital market, securities are not perceived by citizens as a profitable investment. As little as 6.1 per cent define government securities as good investment, 5.2 per cent define shares as such, and 1.4 per cent – corporate bonds. Another reason for the distrust in financial instruments capacity is the general lack of knowledge (Table 16).

Table 16. Awareness of financial instruments

To what extent are you aware of what the following mean:	RESPONSES "None"
Shares	64.6 per cent
Bonds	71.4 per cent
Stock exchange index	85.7 per cent
Derivatives	90.2 per cent

Regardless of the almost complete lack of absence of information among the public, it seems that the revival in recent years and media coverage of the capital market, as well as compensatory instruments topic influence the investment intents of the population (though still rather declarative) – 21 per cent of Bulgarians would purchase securities on the stock exchange if they had excessive funds, 12 per cent would make use of expert's advice, and almost 10 per cent would invest if they had more information.

These public attitude and gradually building confidence correspond, to a certain extent, with the views of professionals about the condition and development of the capital market. But while brokers share with certain enthusiasm that the market in Bulgaria progresses, public companies' directors and issuers are more skeptical.

The surveys make it evident that management teams of companies assess the capital market ambiguously, i.e. not only from the stand point of participants, but also from the perspective of the economic situation, public attitude, foreign investor entrants, and future development opportunities. Opinions of intermediaries are "narrower" and concern specific events and not general trends. That is why perceptions of "good" and "evil" on the market differ.

In practical terms, achievements are in the area of:

- Legislation – "the amendment to the law that provided the freedom for more significant investment";

- Supply – “the first auction proposals were submitted, starting with Balkanpharma and other similar companies that released funds that put the market in motion”;
- Demand – “pension funds were allowed to be invested in securities traded on the stock exchange. This triggered an avalanche, as they started to demand and buy on the market, creating a real demand”;
- Entry of foreign investors – “the first investment funds were set up and, as a result, foreign capital started flowing into the country. This triggered the machinery. Now new companies are coming”;
- Enhanced confidence in the market – “shares value was protected”, “all other additional European rules led to enhanced confidence in the capital market”.

The capital market upsurge, according to both brokers and managers, is also due to the forthcoming EU accession of the country. In their projections, whether and for how long this revival will continue, they refer to what is happening in other European countries – *“…they keep on striking records and it is not clear when this process will stop, therefore demand for shares in Bulgaria will be further increasing”* (direct market participants).

On the higher, management level, there are two positive changes reported and marked by criticism:

- Organization – “the system as a mechanism is operating, but the problem is that there is a small amount of commodity, low quality, and low liquidity;
- Regulation – “the capital market is very well regulated, and is at times overregulated. Disclosure requirements in our country are higher than in most developed capital markets”.

Unlike direct participants in market, however, the group of managers believes the upsurge is a temporary phenomenon and anticipates a collapse like the one on the Greek market. The reasons are that *“currently, quality companies are being de-listed, and what remains on the stock exchange is junk; not a single quality company goes public”.* In practice, some of the survey findings indicate that no conditions are currently in place for the development of the capital market.

In addition to the shortage of quality companies, a major problem according to managers, other barriers exist too for the full-fledged operation of the market. On a practical level, these are the following:

- The complicated procedures of “loading” (listing) new companies on the stock exchange – *“in order for a process to start smoothly it should depend on one or two things”;*
- Prolonged periods of time – *“even such a simple point – after you receive approval of the prospectus, you need to wait until this is published in the State Gazette which wastes at least two weeks for the companies”; “the minimum time period for listing of a company is 76 days plus 14 days for the publication in the State Gazette”.*

In addition to professionals, 15 per cent of representatives of the business as a whole consider financing through shares issue as “*impeded by requirements and procedures”*. Issuers, currently on the stock exchange, also think that issue of securities is administratively burdened (57 per cent).

At the management level, barriers to market development are:

- Obligations under AIPOS and its regulations (according to 51 per cent of actual and potential issuers) and, in particular, with regard to transactions with related parties and stakeholders, liquidations of company assets, capital increase and auction proposal for purchase, and swap of shares;
- Mismatch of the type and volume of presented information and the expectations of foreign investors – “this information is not in the form that the foreign investor can use”;
- Excessive optimism with respect to possibilities for a quick profit on the stock exchange – “I am afraid we are coming rather close to the Greek path – euphoria, vigorous investment in shares by small investors, after which there will be a horrible collapse”;
- Leakage of insider information resulting in sharp spikes and speculations – (foreign investors about the stock exchange)”You can not cope with the problem of insider information!” For them, each sudden fluctuation is a hint of something irregular”;
- Spontaneity of supply and lack of strategy to attract new companies – “in my opinion, this should be a problem of the Bulgarian Stock Exchange and not of the Government. It should attract issuers. In New York they have a special position: “Customer attraction”. The stock exchange should by itself search for what to do”;
- Inadequate prices of offered securities – “there are many companies whose share price should be below the nominal value. This is what it is on the stock exchange, and when making a new offering, they cannot offer it below the nominal value by law, i.e. these are totally out of interest for the investors”;
- Majority of individuals holding one share – “there should be a clause about small shares. Otherwise it is senseless. This share is, in actual fact, no one’s”;
- Forced listing of companies on the stock exchange – “the capital market emerges with the first wave of the voucher privatization, and the major part of companies that are on the stock exchange at that time are there for this reason and not because their managers or shareholders are interested in becoming a public company”.

General prospects facing the capital market in Bulgaria

Reference features. Everything stated thus far can be summarized and developed in the following way. The capital market in general, and the BSE-Sofia in particular, remain in low popularity and/or unknown as an alternative environment for financing potential issuers of publicly traded securities (a problem "on the side of supply"). Thus, a very small portion of the Bulgarian economy is represented on the stock exchange.

The market, and again the stock exchange in particular, remain unpopular and/or unknown to potential investors. This particularly applies to the mass investor (saver) who should be a major factor for a vital market but who keeps searching for other though extremely limited financial products and services (a problem "on the demand side"). The activity level of the stock exchange is distributed mainly among a limited number of participants.

The presence of professional and foreign investors on the capital market in our country for the last several years has been limited. Yet, some indications of revival are in place and attraction of professional and foreign investors reveals a great potential.

A great part of volumes and turnovers of BSE-Sofia are due to transactions with "atypicall" instruments (compensatory instruments and investment vouchers). These instruments, despite their paramount importance for other reasons, are of complementary and temporary presence on the stock exchange. The interest in trading in such instruments to some extent contributed to raising the interest and trust in the capital market as a whole, but their importance from the point of view of vitality of the Bulgarian capital market is limited.

Especially after 2001, we have been witnessing increased stock exchange privatization (particularly the sale of residual and/or minority packages). Though somewhat late (and still limited on the background of the good potential of the capital market), this approach of the government probably contributes to some extent in increasing the liquidity, and hence – the yield realized by the capital market. In the end, the impact of the stock exchange privatization on the capital market is limited. In addition, privatization is a process limited by time, therefore its importance for the market from the strategic point of view is slight [53].

The last conclusion would be debatable if stock exchange had more than a temporary effect on liquidity. It is a fact, however, that secondary trading is generally based on an extremely limited "free float" of the capital of public companies. In this sense, as already emphasized, market capitalization indicators frequently overestimate the actual potential of the market.

Liquidity is generally improving, but remains low and limited to a small number of issues. Attraction of new issuers remains the major challenge to BSE-Sofia that can most directly address the problem of liquidity.

The bond market is of secondary importance for the capital market today. However, from the stand point of BSE-Sofia development, this market has a great potential as well.

Because of the block deals and other negotiated transactions (some of which are not included in the representative exchange prices), the turnover and volume of actual trade on the stock exchange is in fact higher than those frequently presented.

The tax regime on the capital market today contains very few incentives and is rarely the leading motive in investment decision-making or issuers' conduct. Therefore, without improvement and tax incentives, the tax regime cannot become one of the factors determining the market's future.

In addition to everything else, the capital market faces (probably increasing) competitive pressure from the alternative channels of financial intermediation – the banking system, in particular, but also by other channels of resource distribution (for instance insurance and leasing). Of course, the reverse positive effect is also possible (for instance banks as issuers to be presented on the stock exchange or insurance and pension companies to invest in publicly traded securities), but it remains limited at the present time. Many of the banks in Bulgaria, including foreign ones, are still to discover investment banking as a new prospective niche and to find their competitive advantage there.

Last but not least, the capital market (and BSE-Sofia) is to develop in an increasingly competitive and changing environment due to the processes of developing the single market for financial services in the EU. A series of institutional and legal initiatives has been undertaken over the recent years for the integration of financial markets in Europe. Processes of consolidation and internationalization are also driven by purely market reasons.

Common scenarios for CEE stock exchanges. Another point of view towards the prospects of BSE-Sofia in particular is to see them in light of the accomplishments and already identified problems in the other acceding (or already acceded) countries to the EU. Bulgaria, especially in view of its relatively small capital market even in the regional background, can hardly offer any alternative scenario of development over the coming years.

[53] This conclusion has its major exceptions, one of which of course is the sale of the residual share of BTC.

Various analyses are in place for the common scenarios faced by Central and Eastern European stock exchanges, and they are unanimous in one of their conclusions – individual survival of these exchanges will be extremely difficult. The following possible scenarios of their development can be summarized:

- Attempts for individual survival – these will be related mostly to the need for cutting down the costs of individual market places and at the same time increasing the revenues (which supposedly attract issuers and enhance liquidity).
- Strategic alliances – already known in the European practice. Alliances in this sense do not mean mergers or amalgamations but various ways of information exchange, coordination of rules, creating the capacity for use of common platforms for placing of orders, trading, and closing of deals.
- Amalgamations – in various forms (mergers, take-overs, acquisitions or equity participation). The European practice has already provided examples of such development scenarios even within the current EU.

Amalgamation is the ultimate form of cooperation between stock exchanges of a given region, but a merger in which BSE-Sofia may fully participate currently seems too far-fetched. However, various forms and stages of enhanced regional cooperation are possible, and the leading goal should always be the increased liquidity as an indicator of development. Sometimes gathering regional liquidity in one national market[54] is the optimum solution.

Challenges facing BSE-Sofia

It is not only that the present role of the capital market within the financial sector of the country is limited, but also the prospects for its development in the immediate future are contradictory despite the positive trends in recent years and the positive immediate expectations. Some of the greatest strategic challenges of domestic nature faced by the Bulgarian capital market are as follows:

- Diminishing importance of privatization via the stock exchange.
- Temporary nature of secondary trading with non-monetary payment instruments.
- Growing competition by other channels of financial intermediation (the banking system in particular).
- Insufficient popularity of the Bulgarian capital market among local investors and issuers[55].

Other challenges can be added to the above, related to the EU accession process and market globalization:

- Need for further improvement and harmonization of the regulatory framework and the market infrastructure[56].
- Growing competition on behalf of foreign securities markets that can attract large Bulgarian companies.
- Growing competition provoked by prospects of more free provision for financial services that would lead to better opportunities for Bulgarian investors to directly participate in foreign markets.
- Growing competition for Bulgarian intermediaries due to the entry of foreign intermediaries into the local market.
- A possible “crowding-out” effect for the capital market as an alternative channel of intermediation under the pressure of funds flowing into Bulgaria from the European Funds or in the form of direct foreign investments.

The above list is far from exhaustive, still it outlines the need for institutions and participants in the Bulgarian capital market to undertake strategic actions aimed at achieving stability of the market by and following 2007. The major directions of such actions are outlined below.

Strategic directions of development

Attraction of issuers. The lack of sufficient interest with issuers to raise capital through the stock exchange presents a major problem. That is why there is no sufficient free float of attractive shares from the majority of issues despite some positive trends. Attracting new issuers to BSE-Sofia should be perceived as a primary challenge, and the required measures could be summarized as follows:

- Justification and promotion of the new opportunities for beneficial financing through the capital market for potential issuers.
- Special interest towards attracting issuers of corporate bonds to the primary market of the stock exchange.
- Shortening the time limits and burdens for registration of new issues.
- Periodic analyses to identify potential and attractive new issuers.
- Individual approach to potential issuers.
- Attracting SME, including start-ups as a particularly prospective niche (accompanied by renewed efforts to create a special market segment for them).
- Using the argument of the successful stock exchange privatization, attracting the remaining large privatization transactions to the stock exchange with a possibility solely

[54] To be more precise, acceptance of a national trading platform by the other countries and provision of common access to it following the example of the OMX Group encompassing North European and Baltic stock exchanges. On 27 September 2004 several countries adopted the common platform SAXESS already in operation in Sweden. For details: www.omxgroup.com

[55] As regards issuers, in addition to the findings of the sociological surveys stated above, this was also confirmed by the Report on World Competitiveness of the World Economic Forum in Davos, disseminated in October 2004. In this report, interviewed entrepreneurs ranks Bulgaria 87th out of 104 countries by the indicator “access to the local capital market”.

[56] A good example to this end could be the otherwise well developed Bulgarian clearing and settlement system in the area of capital market. Here challenges result to a great extent from the existing problems of integration within the EU itself – ref. Giovannini group final report (2003) of April 2003, accessible at: http://europa.eu.int/comm/economy_finance/publications/giovannini/clearing_settlement_arrangements140403.pdf

for minority blocks (like CHPPs, Municipal bank, cigarette factories).

Tax incentives. Tax incentives not only for issuers, but also for investors and various groups of intermediaries remain an underutilized, yet powerful incentive mechanism for the market. Some of the possibilities to this end are as follows:

- Tax privileges for individuals investing in securities on the stock exchange, similar to those existing for payments for voluntary social and other insurance.
- Tax exemption of dividends distributed by investment companies.
- Tax exemption of income of companies with special investment purpose.
- For legal entities trading in securities on a regulated market – limitation of the amount of the negative difference by which the financial result is increased for tax purposes under art. 23, para 2, it. 17 of CITA.
- Tax incentives for public companies – issuers.

New products and markets. BSE-Sofia needs to look for various possibilities to attract additional business with more financial instruments, including for example expansion on the money market. Efforts could be employed along the following lines: encouraging the currently existing market of government securities on the stock exchange, organizing an electronic market of government securities, attracting and organizing (part of the) trading on the interbank currency and money market.

These are all good possibilities, however, based on the classical understanding of the capital market as a market of financial instruments with maturity of one year and above, in particular shares and long-term bonds, strategic efforts should be focused mainly in this direction. As much as interest in issuing and trading on the stock exchange of stocks and bonds as basic instruments can be stimulated also by diverse related derivative products, among the available (at least hypothetically) possibilities closer to the fundamental factors for the development of the capital market, there seems to be the possibility for creation of a derivative market on BSE-Sofia.

At the end of 2004, by assignment of the stock exchange, a survey was conducted[57] of the prospects for organization of such a market and creating such products by BSE-Sofia. The findings are at the disposal of the stock exchange management, and these prove that, as of today, practically no conditions (and to some extent interest) are in place for introducing a derivatives market.

However, this prospect is to be periodically reassessed, and the survey in question suggests a general action plan in this respect.

Organizational and structural development of BSE-Sofia

There are probably at least four directions to work in with regard to the strategic development of BSE-Sofia.

As much as attraction of new issuers is the major challenge to the stock exchange, it should specially intensify its efforts in this direction – even at the cost of strengthening its resource capacity by setting up a new department for attracting potential issuers (and not just working with existing ones).

Other recurrent observations, related of course to frequently limited liquidity, are the possibilities for manipulation of the market. These attempts or actual situations are fatal for investors' confidence (local or foreign) and indirectly increase the cost of potential financing through the Bulgarian capital market. Therefore, BSE-Sofia needs to focus new efforts on strengthening its supervisory capacity. Particular disciplining effect will probably have the first publicly announced sanctions imposed by the exchange on such occasions.

Thirdly, BSE-Sofia needs to exert efforts towards sudden increase of its analytical capacity even at the cost of hiring external experts. Strengthening the analytical and research activity of the stock exchange will bring it closer to its analogues in more developed countries. First of all, more and better quality analyses will help the management of BSE-Sofia in the process of justification and decision-making. Second, such a new function may significantly raise the reputation of the exchange. Third, the analytical and research activity may highly facilitate the general promotion of the stock exchange. And lastly, certain forms of analytical and research activity may provide a source of additional revenues.

The fourth development of the organizational and structural nature of BSE-Sofia that would have immediate impact on the market is the enhanced integration between the stock exchange and the depository. This may be a lengthy and stage-by-stage process but there exist arguments in its favor. The first argument is optimization of costs (hence – reduction of prices for provided services) of both institutions. The other arguments can be sought in the processes of regional consolidation and the competitive pressure – both institutions will find it difficult to stay out of these processes, but the integration of the market infrastructure can significantly raise their weight and attractiveness in the views of their regional partners (and also of their members, shareholders and all investors).

General promotion of BSE-Sofia. An acute necessity is in place for a general promotion of the capital market and BSE-Sofia, in particular. Promotion among potential issuers is of paramount importance, but specific measures should be developed and undertaken for the general promotion as well.

[57] By OEN consulting – Nageli & Partner, Switzerland

Large-scale and regular presence in the media is required, including non-specialized media. Opportunities provided by the capital market and the trust and safety of BSE-Sofia should be broadly advertised.

In this respect, it is advisory to organize periodic sociological surveys of attitudes, similar to the one already presented above.

Regional policy of BSE-Sofia. The regional policy, and in particular the establishment of strategic partnership with EU market(s), remains another basic challenge to BSE-Sofia. Most likely, in the mid-term the stock exchange will not be able to sustain the competitive pressure without looking for regional cooperation.

Analyzing alternatives and undertaking targeted actions are still to be made. However, as early as now, it can be stated that strong arguments exist for specific cooperation with the Athens Stock Exchange. Several steps have been taken over the recent years to this end, but efforts need to be increased at least for the following reasons.

First, the regional closeness makes the two markets more attractive to each other than, for instance, a market in Central Europe. Second, the presence of Greek investments and companies in Bulgaria, as well as the strong economic cooperation between the two countries, will inevitably contribute to the promotion abroad of the Bulgarian capital market. Special emphasis needs to be placed on the active presence of Greek investors in the Bulgarian financial system that can be a natural “bridge” in the integration of the two markets. Last but not least, cooperation with a market from the EU and the Euro zone needs to be a priority for BSE-Sofia in the context of the general economic policy of Bulgaria.

Indeed, cooperation between the stock exchanges in the region may acquire various forms in the whole spectrum of instruments - from equity, through cross-listing of issues on more than one market, up to harmonization and integration of platforms for order placing, trading, and settlement. In addition, cooperation will probably be implemented on a multilateral and bilateral basis. It is also necessary to take into account the fact that the answers to a part of these questions presuppose purely political decisions, i.e. in this respect responsibility is borne not only by BSE-Sofia.

As already emphasized at the beginning, the above listed actions and measures for strategic development cannot be undertaken and brought to an end solely by BSE-Sofia. In addition, this is not a comprehensive list of all that is needed for the improvement of our capital markets, but refers only to what is assumed to be able to enhance it in the immediate time horizon – up to 2007.

The above-presented general development strategy is probably incomplete and does not literally reflect the view points of institutions directly in charge of the future of the capital markets in Bulgaria. However, everything described above provides a possible analytical foundation for initiating public debates on various aspects of market development. General strategic intents and actions should, in the end, be covered by a broadly discussed and consensus program for implementation in the medium term. Such a feasible program needs to contain the more specific measures, their prioritization, stages, and time limits, as well as responsibilities for implementation.

Economic dynamics

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3	Q4	Year
Industrial production																	
Industrial production, volume index, 2000 =100, %																	
2005	135.4	138.6															
2004	122.1	128.3	145.4	130.9	131.8	147.7	145.9	139.2	150.2	149.2	159.6	172.7	131.9	136.8	145.1	160.5	143.6
2003	111.9	107.3	125.5	114.2	108.3	121.4	125.6	117.8	128.3	130.8	130.2	142.1	114.9	114.6	123.9	134.4	122.0
Industrial production, volume index, previous month =100, %																	
2005	78.4	102.4											-	-	-	-	-
2004	85.9	105.1	113.3	90.0	100.7	112.1	98.8	95.4	107.9	99.3	107.0	108.2	-	-	-	-	-
2003	93.2	95.9	117.0	91.0	94.8	112.1	103.5	93.8	108.9	101.9	99.5	109.1	-	-	-	-	-
Industrial production, volume index, corresponding period of the previous year = 100, %																	
2005	110.9	108.0															
2004	109.1	119.6	115.9	114.6	121.7	121.7	116.2	118.2	117.1	114.1	122.6	121.5	114.8	119.3	117.1	119.5	117.7
2003	118.9	114.4	122.6	109.8	107.9	113.8	111.9	109.6	114.9	116.6	110.2	118.3	118.7	110.5	112.2	115.0	114.0
Industrial production, from the beginning of the year, volume index, corresponding period of the previous year = 100, %																	
2005	110.9	109.4															
2004	109.1	114.2	114.8	114.8	116.1	117.1	116.9	117.1	117.1	116.8	117.3	117.7	114.8	117.1	117.1	117.7	117.7
2003	118.9	116.7	118.7	116.4	114.7	114.5	114.1	113.5	113.7	114.0	113.6	114.0	118.7	114.5	113.7	114.0	114.0
Industrial sales																	
Industrial sales, volume index, 2000 =100, %																	
2005	135.8	136.5															
2004	114.9	126.0	144.8	136.3	132.7	153.4	155.9	143.4	158.6	157.3	167.9	176.1	128.6	140.8	152.6	167.1	147.3
2003	108.1	104.1	124.8	114.1	112.5	122.8	125.9	118.3	125.7	129.7	127.5	138.0	112.3	116.5	123.3	131.7	121.0
Industrial sales, volume index, previous month =100, %																	
2005	77.1	100.5											-	-	-	-	-
2004	83.3	109.7	114.9	94.1	97.4	115.6	101.6	92.0	110.6	99.2	106.7	104.9	-	-	-	-	-
2003	91.7	96.3	119.9	91.4	98.6	109.2	102.5	94.0	106.3	103.2	98.3	108.2	-	-	-	-	-
Industrial sales, volume index, corresponding period of the previous year = 100, %																	
2005	118.2	108.3															
2004	106.3	121.0	116.0	119.5	118.0	124.9	123.8	121.2	126.2	121.3	131.7	127.6	114.5	120.9	123.8	126.8	121.8
2003	117.8	115.8	130.0	109.6	116.2	117.1	112.2	110.5	115.2	120.1	113.2	117.0	121.4	114.3	112.6	116.8	116.1

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3	Q4	Year
Industrial sales, from the beginning of the year, volume index, corresponding period of the previous year = 100, %																	
2005	118.2	113.0															
2004	106.3	113.5	114.5	115.7	116.2	117.7	118.7	119.0	119.9	120.0	121.1	121.8	114.5	117.7	119.9	121.8	121.8
2003	117.8	116.8	121.4	118.2	117.8	117.6	116.8	115.9	115.8	116.3	116.0	116.1	121.4	117.6	115.8	116.1	116.1
Trade																	
Trade and repairing activities, net receipts from sales, volume index, 2000 =100, %																	
2005	146.3	145.7															
2004	126.8	134.4	137.5	136.6	137.1	143.0	153.2	159.2	166.4	168.9	176.3	192.0	132.9	138.9	159.6	179.1	152.6
2003	120.0	127.3	137.3	133.1	135.3	139.1	148.3	149.5	152.5	158.5	149.1	170.0	128.2	135.8	150.1	159.2	143.3
Trade and repairing activities, net receipts from sales, volume index, previous month =100, %																	
2005	76.2	99.6											-	-	-	-	-
2004	74.6	106.0	102.3	99.3	100.4	104.3	107.1	103.9	104.5	101.5	104.4	108.9	-	-	-	-	-
2003	82.8	106.1	107.9	96.9	101.7	102.8	106.6	100.8	102.0	103.9	94.1	114.0	-	-	-	-	-
Trade and repairing activities, net receipts from sales, volume index, corresponding period of the previous year = 100, %																	
2005	115.4	108.4															
2004	105.7	105.6	100.1	102.6	101.3	102.8	103.3	106.5	109.1	106.6	118.2	112.9	103.7	102.3	106.3	112.5	106.5
2003	118.0	118.9	119.8	121.3	121.5	119.1	117.8	114.7	116.7	115.8	112.6	117.2	118.9	120.6	116.4	115.3	117.6
Trade and repairing activities, net receipts from sales, volume index, from the beginning of the year, corresponding period of the previous year =100, %																	
2005	115.4	111.8															
2004	105.7	105.6	103.7	103.4	103.0	102.9	103.0	103.5	104.2	104.4	105.8	106.5	103.7	102.9	104.2	106.5	106.5
2003	118.0	118.4	118.9	119.5	119.9	119.8	119.5	118.8	118.5	118.2	117.6	117.6	118.9	119.8	118.5	117.6	117.6
Inflation																	
Inflation (Consumer price index - 100), previous month =100, %																	
2005	0.7	0.9	0.3										-	-	-	-	-
2004	1.4	0.3	-0.1	0.3	0	-1.8	1.2	-0.4	0.9	0.2	0.6	1.3	-	-	-	-	-
2003	0.6	0.1	0.4	0.3	-0.6	-2.2	0.9	0.8	0.9	0.7	1.8	1.8	-	-	-	-	-
Inflation (Consumer price index - 100), December of the previous year = 100, %																	
2005	0.7	1.6	1.9										-	-	-	-	-
2004	1.4	1.7	1.7	1.9	2	0.2	1.4	0.9	1.9	2	2.7	4	-	-	-	-	-
2003	0.6	0.8	1.2	1.5	0.8	-1.4	-0.5	0.3	1.2	1.9	3.8	5.6	-	-	-	-	-
Inflation (Consumer price index - 100), corresponding period of the previous year = 100, %																	
2005	3.3	3.9	4.3										3.8				
2004	6.4	6.6	6.2	6.1	6.8	7.3	7.6	6.3	6.3	5.8	4.5	4.0	6.4	6.7	6.8	4.7	6.1
2003	1.7	0.2	-0.2	0.3	1.7	1.3	2.0	3.5	3.6	3.3	5.1	5.6	0.6	1.1	3.1	4.7	2.3

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3	Q4	Year
Employment and unemployment																	
Unemployed persons registered, total, end of the period, number																	
2005	486 414	485 504															
2004	537 137	527 258	507 508	487 814	466 717	452 428	446 784	442 190	434 737	437 493	440 039	450 566	507 508	452 428	434 737	450 566	450 566
2003	646 757	611 727	581 350	552 068	528 718	506 424	489 343	480 881	472 614	476 326	489 618	500 664	581 350	506 424	472 614	500 664	500 664
Unemployment (Employment Agency, ratio to the economically active population from the population census in 2001), end of the period, %																	
2005	13.13	13.11															
2004	14.50	14.23	13.7	13.17	12.6	12.21	12.06	11.94	11.74	11.81	11.88	12.16	13.70	12.21	11.74	12.16	12.16
2003	17.46	16.51	15.69	14.90	14.27	13.67	13.21	12.98	12.76	12.86	13.22	13.52	15.69	13.67	12.76	13.52	13.52
Newly opened vacant jobs, for the period, number																	
2005	2 466	2 122											-	-	-	-	-
2004	3 286	4 772	5 050	3 538	4 090	4 571	4 085	2 966	3 009	6 232	7 198	2 992	-	-	-	-	-
2003	1 759	2 024	2 136	2 480	2 349	6 076	3 890	2 782	2 804	3 365	3 516	3 999	-	-	-	-	-
Employed person, total, end of the period, number																	
2004	2 089 842	2 107 924	2 127 689	2 146 489	2 162 177	2 175 873	2 186 757	2 181 207	2 170 404	2 162 474	2 144 427	2 109 478	2 127 689	2 175 873	2 170 404	2 109 478	2 109 478
2003	1 946 834	1 991 623	2 016 828	2 043 764	2 054 972	2 068 694	2 075 881	2 067 291	2 063 429	2 050 282	2 034 033	2 005 369	2 016 828	2 068 694	2 063 429	2 005 369	2 005 369
Employed person, public sector, end of the period, number																	
2004	751 635	759 485	766 657	767 878	769 983	770 520	742 194	738 504	739 786	737 760	733 506	717 920	766 657	770 520	739 786	717 920	717 920
2003	730 873	757 271	765 688	771 192	771 746	775 281	778 647	776 774	778 293	772 629	768 505	758 795	765 688	775 281	778 293	758 795	758 795
Employed person, private sector, end of the period, number																	
2004	1 338 207	1 348 439	1 361 032	1 378 611	1 392 194	1 405 353	1 444 563	1 442 703	1 430 618	1 424 714	1 410 921	1 391 558	1 361 032	1 405 353	1 430 618	1 391 558	1 391 558
2003	1 215 961	1 234 352	1 251 140	1 272 572	1 283 226	1 293 413	1 297 234	1 290 517	1 285 136	1 277 653	1 265 528	1 246 574	1 251 140	1 293 413	1 285 136	1 246 574	1 246 574
Employed person, total, end of the period, growth to corresponding month of previous year=100																	
2004	7.3	5.8	5.5	5.0	5.2	5.2	5.3	5.5	5.2	5.5	5.4	5.2	5.5	5.2	5.2	5.2	5.2
2003	3.6	5.7	6.7	7.8	7.8	8.1	8.2	8.0	7.2	6.9	6.0	4.9	6.7	8.1	7.2	4.9	4.9
Employed person, public sector, end of the period, growth to corresponding month of previous year=100																	
2004	2.8	0.3	0.1	-0.4	-0.2	-0.6	-4.7	-4.9	-4.9	-4.5	-4.6	-5.4	0.1	-0.6	-4.9	-5.4	-5.4
2003	-4.0	-0.6	0.7	2.9	3.5	4.3	5.6	5.6	5.1	5.0	2.8	0.3	0.7	4.3	5.1	0.3	0.3
Employed person, private sector, end of the period, growth to corresponding month of previous year=100																	
2004	10.1	9.2	8.8	8.3	8.5	8.7	11.4	11.8	11.3	11.5	11.5	11.6	8.8	8.7	11.3	11.6	11.6
2003	8.9	10.1	10.8	11.0	10.6	10.5	9.9	9.5	8.5	8.1	8.1	8.0	10.8	10.5	8.5	8.0	8.0

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3	Q4	Year
Fiscal review																	
State budget																	
Revenues of the Consolidated State Budget, total, BGN million																	
2005	1 326.2	2 536.1															
2004	1 126.0	2 110.6	3 636.8	5 097.6	6 375.6	7 646.9	8 996.5	10 311.4	11 622.1	12 978.2	14 304.5	15 858.1	3 636.8	7 646.9	11 622.1	15 858.1	15 858.1
2003	1 029.2	1 944.8	3 220.6	4 631.2	5 813.3	6 830.5	8 054.1	9 158.9	10 311.4	11 573.2	12 657.0	14 072.0	3 220.6	6 830.5	10 311.4	14 072.0	14 072.0
Expenditures of the Consolidated State Budget, total, BGN million																	
2005	1 238.2	2 401.7															
2004	1 152.7	2 260.2	3 408.4	4 568.7	5 665.8	6 769.3	8 019.8	9 119.7	10 322.3	11 502.8	12 826.5	15 198.9	3 408.4	6 769.3	10 322.3	15 198.9	15 198.9
2003	1 130.6	2 105.4	3 109.8	4 221.5	5 195.0	6 203.4	7 402.7	8 429.7	9 463.7	10 602.5	11 758.1	14 071.1	3 109.8	6 203.4	9 463.7	14 071.1	14 071.1
Consolidated State Budget deficit (-) /surplus (+), BGN million																	
2005	88.0	134.4															
2004	-26.7	-149.5	228.4	528.9	709.7	877.6	976.7	1191.7	1299.7	1475.3	1478.0	659.2	228.4	877.6	1 299.7	659.2	659.2
2003	-101.5	-160.6	110.8	409.7	618.3	627.1	651.4	729.2	847.8	970.7	898.9	0.9	110.8	627.1	847.8	0.9	0.9
Revenues of the Republican Budget, total, BGN million																	
2005	908.8	1 670.6															
2004	777.1	1 368.7	2 343.4	3 368.2	4 241.3	5 098.0	5 912.6	6 764.3	7 571.6	8 434.5	9 276.0	10 186.8	2 343.4	5 098.0	7 571.6	10 186.8	10 186.8
2003	651.3	908.4	1 937.0	2 878.1	3 626.4	4 221.2	4 985.2	5 637.7	6 279.0	7 051.8	7 684.9	8 441.6	1 937.0	4 221.2	6 279.0	8 441.6	8 441.6
Expenditures of the Republican Budget, total, BGN million																	
2005	859.6	1 624.7															
2004	841.2	1 531.5	2 222.5	2 963.0	3 640.1	4 315.5	5 134.6	5 773.9	6 575.3	7 249.0	8 019.3	9 757.0	2 222.5	4 315.5	6 575.3	9 757.0	9 757.0
2003	737.0	1 195.6	1 846.2	2 594.1	3 016.6	3 639.2	4 372.7	4 979.0	5 520.4	6 200.7	6 952.7	8 552.2	1 846.2	3 639.2	5 520.4	8 552.2	8 552.2
Republican Budget cash deficit (-) / surplus (+), BGN million																	
2005	49.2	45.9															
2004	-64.0	-162.8	120.9	405.3	601.2	782.4	778.0	990.4	996.3	1 185.6	1 256.6	429.7	120.9	782.4	996.3	429.7	429.7
2003	-85.7	-287.2	90.8	284.0	609.7	582.0	612.4	658.7	758.5	851.1	732.2	110.6	90.8	582.0	758.5	110.6	110.6
Government and government guaranteed debt																	
Government and government guaranteed debt, BGN million																	
2005	14 387.5	14 210.7															
2004	16 731.7	16 852.8	17 032.7	17 332.8	17 187.1	17 198.8	16 089.2	16 068.7	16 054.2	15 927.5	15 677.9	15 557.3	17 032.7	17 198.8	16 054.2	15 557.3	15 557.3
2003	17 547.9	17 638.7	17 560.2	17 679.7	17 062.1	17 364.8	17 466.7	17 858.3	17 194.7	17 140.1	16 930.8	16 509.7	17 560.2	17 364.8	17 194.7	16 509.7	16 509.7

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3	Q4	Year
Domestic government and government guaranteed debt, BGN million																	
2005	2 700.2	2 724.9															
2004	2 331.3	2 397.3	2 425.6	2 462.3	2 475.3	2 494.5	2 494.7	2 536.8	2 568.9	2 597.8	2 627.4	2 680.6	2 425.6	2 494.5	2 568.9	2 680.6	2 680.6
2003	2 113.5	2 207.4	2 290.7	2 246.2	2 225.5	2 233.9	2 215.4	2 236.5	2 218.1	2 193.7	2 248.4	2 241.2	2 290.7	2 233.9	2 218.1	2 241.2	2 241.2
Foreign government and government guaranteed debt, BGN million																	
2005	11 687.3	11 485.8															
2004	14 400.4	14 455.5	14 607.1	14 870.4	14 711.9	14 704.3	13 594.6	13 531.8	13 485.4	13 329.8	13 050.7	12 876.6	14 607.1	14 704.3	13 485.4	12 876.6	12 876.6
2003	15 434.4	15 431.3	15 269.8	15 433.7	14 836.3	15 131.1	15 251.2	15 621.8	14 976.6	14 946.6	14 683.4	14 268.6	15 269.8	15 131.1	14 976.6	14 268.6	14 268.6
Government and government guaranteed debt, ratio to the annual GDP, %																	
2005	34.8	34.4															
2004	44.1	44.4	44.8	45.6	45.2	45.3	42.4	42.3	42.3	41.9	41.3	40.9	44.8	45.3	42.3	40.9	40.9
2003	49.7	50.0	49.8	50.1	48.4	49.2	49.5	50.6	48.7	48.6	48.0	47.8	49.8	49.2	48.7	47.8	47.8
Domestic government and government guaranteed debt, ratio to the annual GDP, %																	
2005	6.5	6.6															
2004	6.1	6.3	6.4	6.5	6.5	6.6	6.6	6.7	6.8	6.8	6.9	7.0	6.4	6.6	6.8	7.0	7.0
2003	6.0	6.3	6.5	6.4	6.3	6.3	6.3	6.3	6.3	6.2	6.4	6.5	6.5	6.3	6.3	6.5	6.5
Foreign government and government guaranteed debt, ratio to the annual GDP, %																	
2005	28.3	27.8															
2004	37.9	38.1	38.5	39.2	38.7	38.7	35.8	35.6	35.5	35.1	34.4	33.8	38.5	38.7	35.5	33.8	33.8
2003	43.7	43.7	43.3	43.7	42.0	42.9	43.2	44.3	42.4	42.4	41.6	41.3	43.3	42.9	42.4	41.3	41.3
Domestic government debt, total, BGN million																	
2005	2 700.2	2 724.9															
2004	2 331.3	2 397.2	2 425.7	2 462.3	2 475.3	2 494.5	2 494.7	2 536.8	2 568.9	2 597.8	2 627.4	2 680.6	2 425.7	2 494.5	2 568.9	2 680.6	2 680.6
2003	2 111.6	2 205.8	2 289.4	2 245.3	2 225.1	2 233.9	2 215.5	2 236.5	2 218.2	2 193.6	2 248.4	2 241.1	2 289.4	2 233.9	2 218.2	2 241.1	2 241.1
Debt on Government Securities issued for budget deficit financing, BGN million																	
2005	2 253.3	2 281.4															
2004	1 822.7	1 889.3	1 914.9	1 949.0	1 967.8	1 986.8	1 985.9	2 033.6	2 072.6	2 112.2	2 151.6	2 211.2	1 914.9	1 986.8	2 072.6	2 211.2	2 211.2
2003	1 515.4	1 608.5	1 696.0	1 658.9	1 658.5	1 658.2	1 637.7	1 652.5	1 653.9	1 633.2	1 696.7	1 703.9	1 696.0	1 658.2	1 653.9	1 703.9	1 703.9
Debt on Government Securities issued for structural reform, BGN million																	
2005	447.0	443.5															
2004	508.6	508.0	510.8	513.3	507.4	507.6	508.9	503.2	496.3	485.6	475.8	469.5	510.8	507.6	496.3	469.5	469.5
2003	596.2	597.2	593.4	586.4	566.6	575.7	577.7	584.0	564.3	560.4	551.6	537.2	593.4	575.7	564.3	537.2	537.2

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3	Q4	Year
Foreign government debt, USD million																	
2005	7 198.4	7 189.7															
2004	8 620.0	8 635.2	8 587.7	8 545.4	8 621.3	8 587.6	7 815.4	7 821.0	8 004.8	8 117.7	8 286.0	8 362.7	8 587.7	8 587.6	8 004.8	8 362.7	8 362.7
2003	8 109.3	8 091.6	8 090.0	8 355.8	8 535.8	8 414.6	8 372.2	8 284.1	8 461.0	8 417.2	8 530.4	8 718.6	8 090.0	8 414.6	8 461.0	8 718.6	8 718.6
Foreign government guaranteed debt, USD million																	
2005	590.7	595.6															
2004	498.1	542.9	541.8	538.0	554.2	550.7	552.7	558.2	551.1	563.0	585.4	604.8	541.8	550.7	551.1	604.8	604.8
2003	426.3	415.3	416.0	427.8	432.0	425.8	453.4	443.6	461.3	464.3	473.5	495.5	416.0	425.8	461.3	495.5	495.5
Foreign economic relations and foreign investments																	
Balance of Payments																	
Current account, million USD																	
2005	-377.7																
2004	-290.7	-162.9	-172.0	-269.6	-262.1	-22.8	262.9	178.5	50.0	-269.0	-461.6	-386.7	-625.6	-554.5	491.4	-1 117.3	-1 806.0
2003	-183.1	-162.8	-100.6	-408.0	-256.0	20.6	22.3	136.1	-1.3	-250.5	-327.7	-344.9	-446.5	-643.4	157.1	-923.1	-1 855.9
Trade balance, (FOB), million USD																	
2005	-261.5																
2004	-194.6	-183.8	-256.2	-321.4	-369.8	-260.9	-161.2	-209.8	-190.7	-305.5	-460.9	-438.0	-634.6	-952.1	-561.7	-1 204.4	-3 352.8
2003	-72.3	-121.4	-118.3	-273.2	-302.0	-161.1	-205.5	-155.1	-149.4	-262.2	-321.1	-376.9	-312.0	-736.3	-510.0	-960.2	-2 518.5
Exports (FOB), million USD																	
2005	838.4																
2004	631.8	736.4	780.3	716.8	721.3	847.7	964.8	816.0	894.3	923.7	949.7	875.8	2 148.5	2 285.8	2 675.1	2 749.2	9 858.6
2003	564.8	542.0	648.5	585.5	596.0	657.2	708.1	604.5	657.7	704.6	635.0	636.9	1 755.3	1 838.7	1 970.3	1 976.5	7 540.8
Imports (FOB), million USD																	
2005	-1099.9																
2004	-826.4	-920.2	-1036.5	-1038.2	-1091.1	-1108.6	-1126.1	-1025.8	-1085.0	-1229.2	-1410.5	-1313.8	-2 783.1	-3 237.9	-3 236.9	-3 953.5	-13 211.4
2003	-637.1	-663.4	-766.7	-858.7	-898.0	-818.3	-913.6	-759.6	-807.1	-966.8	-956.0	-1013.8	-2 067.2	-2 575.0	-2 480.3	-2 936.6	-10 059.1
Services, net, million USD																	
2005	-30.1																
2004	-25.5	0.9	-10.9	-53.3	80.4	220.5	343.0	315.4	142.8	-30.3	-59.0	-46.6	-35.5	247.6	801.2	-135.9	877.4
2003	-22.4	-14.9	-24.5	-35.9	30.9	169.1	238.1	238.6	124.4	-23.2	-45.6	-41.2	-61.8	164.1	601.1	-110.0	593.4
Income, net, million USD																	
2005	-143.1																
2004	-129.2	-33.8	-9.1	6.7	-38.5	-34.6	-67.0	-29.8	-19.5	-35.5	-39.7	6.1	-172.1	-66.4	-116.3	-69.1	-423.9
2003	-128.9	-54.7	-25.5	-144.8	-29.5	-45.7	-75.2	-20.4	-55.4	-14.2	-13.9	-18.3	-209.1	-220.0	-151.0	-46.4	-626.5

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3	Q4	Year
Current transfers, net, million USD																	
2005	57.0																
2004	58.6	53.8	104.2	98.5	65.8	52.3	148.1	102.8	117.5	102.4	98.0	91.9	216.6	216.6	368.4	292.3	1 093.9
2003	40.5	28.2	67.7	45.9	44.7	58.3	64.9	73.0	79.0	49.1	52.8	91.5	136.4	148.9	216.9	193.4	695.6
Capital account, million USD																	
2005	0.0																
2004	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
2003	0.0	0.0	0.0	0.0	0.0	0.0	0.0	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0	-0.2	-0.1	-0.3
Financial account, million USD																	
2005	-384.6																
2004	-46.0	443.3	296.5	147.4	471.4	596.4	-738.8	116.1	212.3	409.9	607.2	833.0	693.8	1 215.2	-410.4	1 850.1	3 348.7
2003	33.8	111.5	199.5	536.1	263.2	184.9	30.1	130.5	138.2	560.5	261.5	191.0	344.8	984.2	298.8	1 013.0	2 640.8
Direct investment net, million USD																	
2005	29.5																
2004	154.5	145.5	143.2	47.0	95.8	658.5	-863.6	68.7	58.5	197.7	395.9	929.4	443.2	801.3	-736.4	1 523.0	2 031.1
2003	134.6	119.2	194.9	153.9	226.4	159.1	214.9	141.6	130.5	397.2	64.3	133.6	448.7	539.4	487.0	595.1	2 070.2
Direct investment abroad, million USD																	
2005	-10.4																
2004	-6.2	-1.6	-2.6	-0.7	-1.1	-2.3	-2.2	-0.8	-2.7	-4.4	255.0	-2.0	-10.4	-4.1	-5.7	248.6	228.4
2003	-5.8	-0.3	-1.5	-1.5	0.6	-0.5	0.4	-4.3	-2.5	-1.5	-1.3	-8.4	-7.6	-1.4	-6.4	-11.2	-26.6
Direct investment in Bulgaria, million USD																	
2005	40.0																
2004	160.7	147.1	145.8	47.7	96.9	442.4	156.0	69.5	61.2	202.1	140.9	931.4	453.6	587.0	286.7	1 274.4	2 601.7
2003	140.4	119.6	196.3	155.3	225.8	159.6	214.5	145.9	133.0	398.8	65.7	142.0	456.3	540.7	493.4	606.5	2 096.9
Mergers and acquisitions net, million USD																	
2005	0.0																
2004	0.0	0.0	0.0	0.0	0.0	218.5	-1017.3	0.0	0.0				0.0	218.5	-1 017.3	0.0	-798.8
2003	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Portfolio investment assets, million USD																	
2005	253.6																
2004	-64.5	-17.3	36.6	-71.9	27.6	28.2	43.9	18.2	35.4	25.7	249.0	-298.9	-45.2	-16.1	97.5	-24.2	12.0
2003	13.5	9.9	-19.8	10.8	87.3	-37.2	-87.3	-55.9	29.3	-36.7	24.9	-18.6	3.6	60.9	-113.9	-30.4	-79.8

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3	Q4	Year
Portfolio investment liabilities, million USD																	
2005	-974.9																
2004	-106.2	-48.9	43.1	-15.7	8.1	125.0	-747.8	-11.5	25.6	-4.2	28.2	18.5	-112.0	117.4	-733.7	42.5	-685.8
2003	-34.5	-13.4	-22.9	0.4	27.9	1.4	-79.4	-16.7	9.0	-14.9	5.5	4.5	-70.8	29.7	-87.1	-4.9	-133.1
Other investment assets, million USD																	
2005	-83.5																
2004	-97.2	160.2	-37.7	112.9	102.0	-412.2	22.0	8.6	-59.5	-20.7	130.6	-316.0	25.3	-197.3	-28.9	-206.1	-407.0
2003	-10.3	20.1	-55.2	285.6	-123.4	-37.0	-46.1	100.6	-139.6	174.5	114.0	-32.3	-45.4	125.2	-85.1	256.2	250.9
Other investment liabilities, million USD																	
2005	390.6																
2004	67.5	203.9	111.3	75.2	238.0	196.8	806.7	32.1	152.4	211.4	-196.5	500.1	382.7	510.0	991.2	515.0	2 398.9
2003	-69.5	-24.4	102.6	85.4	45.0	98.6	28.1	-39.1	109.0	40.3	52.8	103.9	8.7	229.0	98.0	197.0	532.7
Net Errors and Omissions (BP), million USD																	
2005	111.9																
2004	-45.5	-137.6	78.4	196.8	151.0	-75.3	-99.9	76.5	-16.8	140.1	170.4	-267.9	-104.7	272.5	-40.2	42.6	170.2
2003	-150.5	96.4	-16.6	46.9	97.5	-137.7	-54.1	-149.4	-62.1	21.1	174.6	78.5	-70.7	6.7	-265.6	274.2	-55.4
Overall balance (BP), million USD																	
2005	-650.4																
2004	-382.1	142.8	202.9	74.6	360.4	498.3	-575.8	371.1	245.6	281.1	316.0	178.4	-36.4	933.3	40.9	775.5	1 713.3
2003	-299.8	45.1	82.3	175.0	104.7	67.8	-1.6	117.1	74.7	331.1	108.4	-75.4	-172.4	347.5	190.2	364.1	729.4
Reserves and Related Items, million USD																	
2005	650.4																
2004	382.1	-142.8	-202.9	-74.6	-360.4	-498.3	575.8	-371.1	-245.6	-281.1	-316.0	-178.4	36.4	-933.3	-40.9	-775.5	-1 713.3
2003	299.8	-45.1	-82.3	-175.0	-104.7	-67.8	1.6	-117.1	-74.7	-331.1	-108.4	75.4	172.4	-347.5	-190.2	-364.1	-729.4
Finance																	
Financial indicators																	
Exchange rate BGN / USD, average for the period																	
2005	1.490	1.503	1.482										1.492				
2004	1.549	1.546	1.594	1.633	1.631	1.611	1.594	1.606	1.600	1.566	1.505	1.460	1.564	1.625	1.600	1.511	1.575
2003	1.842	1.816	1.810	1.804	1.684	1.677	1.720	1.756	1.746	1.673	1.672	1.593	1.823	1.721	1.741	1.646	1.733
Exchange rate BGN / USD, end of the period																	
2005	1.500	1.475	1.508										1.509				
2004	1.579	1.575	1.599	1.637	1.603	1.609	1.624	1.614	1.576	1.535	1.471	1.435	1.600	1.609	1.576	1.436	1.436
2003	1.808	1.814	1.795	1.757	1.654	1.712	1.728	1.790	1.679	1.683	1.631	1.549	1.795	1.712	1.679	1.549	1.549

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3	Q4	Year
Basic interest rate, effective annual, average for the period																	
2005	2.41	1.91											1.44				
2004	2.82	2.52	2.44	2.58	2.86	3.84	2.46	2.45	2.42	2.42	2.44	2.38	2.59	3.09	2.44	2.41	2.64
2003	3.27	2.53	2.55	2.60	2.98	2.92	2.54	2.55	2.59	2.62	2.63	2.69	2.78	2.83	2.56	2.65	2.71
Money (M1), BGN million																	
2005	10 045	10 201															
2004	7 788	7 853	7 835	7 987	8 036	8 422	8 736	9 048	9 239	9 220	9 185	10 298	7 835	8 422	9 239	10 298	10 298
2003	6 291	6 377	6 274	6 435	6 560	6 834	7 110	7 314	7 416	7 422	7 377	8 030	6 274	6 834	7 416	8 030	8 030
Money (M2), BGN million																	
2005	20 438	20 705															
2004	16 439	16 655	16 678	17 081	17 270	18 033	18 293	18 282	18 675	18 777	18 791	20 302	16 678	18 033	18 675	20 302	20 302
2003	13 551	13 723	13 542	13 762	13 766	14 197	14 624	15 046	15 073	15 698	15 605	16 465	13 542	14 197	15 073	16 465	16 465
International reserves of BNB, BGN million																	
2005	12 328	12 785															
2004	9 841	10 112	10 494	10 605	11 167	11 953	11 033	11 607	12 163	12 576	12 996	13 242	10 494	11 953	12 163	13 242	13 242
2003	8 363	8 473	8 603	9 233	9 316	9 451	9 518	9 800	9 882	10 413	10 557	10 383	8 603	9 451	9 882	10 383	10 383
Fiscal reserves at the Issue Department of BNB, BGN million																	
2005	3 370	3 756															
2004	3 138	3 147	3 503	3 823	4 204	4 803	3 663	4 347	4 642	4 898	5 384	4 346	3 503	4 803	4 642	4 346	4 346
2003	2 793	2 804	3 028	3 633	3 873	3 747	3 766	3 767	3 832	3 971	4 177	3 280	3 028	3 747	3 832	3 280	3 280
Banking system																	
Claims on credits granted by the Commercial Banks, total, BGN thousand																	
2005	14 339 642	14 669 727															
2004	9565122 [1)]	9 848 840	10 247 405	10 659 517	11 008 716	11 309 097	11 877 533	12 076 182	12 526 708	12 954 946	13 410 638	13 939 177	10 247 405	11 309 097	12 526 708	13 939 177	13 939 177
2003	6 444 818	6 563 130	6 816 766	7 167 024	7 424 452	7 727 590	7 866 307	8 171 994	8 471 157	8 904 325	9 114 301	9 454 164	6 816 766	7 727 590	8 471 157	9 454 164	9 454 164
Credits to Resident Sector, total																	
2005	14 171 157	14 493 674															
2004	9 465 473	9 747 743	10 131 312	10 545 411	10 904 864	11 189 803	11 754 355	11 938 957	12 379 729	12 803 003	13 253 413	13 782 870	10 131 312	11 189 803	12 379 729	13 782 870	13 782 870
2003	6 356 088	6 489 721	6 745 467	7 094 504	7 355 881	7 657 439	7 797 284	8 092 008	8 391 057	8 832 873	9 044 229	9 352 878	6 745 467	7 657 439	8 391 057	9 352 878	9 352 878
Credits to Government Sector																	
2005	26 797	26 657															
2004	24 891	27 795	26 973	26 451	26 628	28 026	28 586	28 556	28 361	28 265	28 505	26 760	26 973	28 026	28 361	26 760	26 760
2003	8 673	8 947	9 494	9 380	9 406	9 561	11 924	13 394	19 928	21 667	22 168	24 635	9 494	9 561	19 928	24 635	24 635

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3	Q4	Year
Credits to Non-government Sector																	
2005	14 132 460	14 455 119															
2004	9 440 582	9 719 596	10 104 001	10 518 659	10 877 937	11 161 514	11 720 617	11 905 251	12 346 446	12 769 818	13 219 990	13 744 209	10 104 001	11 161 514	12 346 446	13 744 209	13 744 209
2003	6 291 902	6 444 260	6 662 763	7 014 528	7 280 799	7 603 463	7 727 111	8 030 421	8 325 688	8 751 119	8 977 126	9 303 120	6 662 763	7 603 463	8 325 688	9 303 120	9 303 120
Credits to Non-financial Public Corporations																	
2005	253 924	242 027															
2004	-	245 972	231 880	232 625	244 408	243 272	226 689	207 946	225 757	266 988	261 609	261 341	231 880	243 272	225 757	261 341	261 341
2003	219 215	229 954	235 631	246 234	245 746	231 489	245 251	237 021	230 292	213 420	217 489	234 230	235 631	231 489	230 292	234 230	234 230
Credits to Non-financial Private Corporations																	
2005	9 112 979	9 287 240															
2004	6785654 [2)]	6 685 783	6 932 080	7 194 675	7 378 415	7 452 693	7 840 566	7 883 985	8 140 365	8 346 028	8 512 148	8 812 722	6 932 080	7 452 693	8 140 365	8 812 722	8 812 722
2003	4 715 900	4 800 569	4 949 708	5 202 209	5 377 904	5 604 204	5 575 897	5 774 664	5 956 901	6 287 344	6 412 770	6 641 717	4 949 708	5 604 204	5 956 901	6 641 717	6 641 717
Credits to Households and NPISH																	
2005	4 458 783	4 610 873															
2004	2 530 436	2 655 236	2 802 335	2 950 438	3 107 317	3 302 537	3 487 977	3 644 450	3 806 347	3 976 297	4 158 518	4 373 864	2 802 335	3 302 537	3 806 347	4 373 864	4 373 864
2003	1 260 492	1 300 531	1 355 108	1 438 127	1 532 501	1 645 779	1 758 072	1 853 587	1 933 809	2 035 462	2 116 719	2 201 298	1 355 108	1 645 779	1 933 809	2 201 298	2 201 298
Credits to Non-bank Financial Institutions																	
2005	306 774	314 979															
2004	124 492	132 605	137 706	140 921	147 797	163 012	165 385	168 870	173 977	180 505	287 715	296 282	137 706	163 012	173 977	296 282	296 282
2003	96 295	113 206	122 316	127 958	124 648	121 991	147 891	165 149	204 686	214 893	230 148	225 875	122 316	121 991	204 686	225 875	225 875
Credits to Monetary Financial Institutions																	
2005	11 900	11 898															
2004	-	352	338	301	299	263	5 152	5 150	4 922	4 920	4 918	11 901	338	263	4 922	11 901	11 901
2003	55 513	36 514	73 210	70 596	65 676	44 415	58 249	48 193	45 441	60 087	44 935	25 123	73 210	44 415	45 441	25 123	25 123
Credits to Non-resident Sector																	
2005	168 485	176 053															
2004	99 649	101 097	116 093	114 106	103 852	119 294	123 178	137 225	146 979	151 943	157 225	156 307	116 093	119 294	146 979	156 307	156 307
2003	88 730	73 409	71 299	72 520	68 571	70 151	69 023	79 986	80 100	71 452	70 072	101 286	71 299	70 151	80 100	101 286	101 286

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3	Q4	Year
Total assets, end of the period, BGN thousand																	
2005	24 597 489	25 134 799															
2004	17 530 661	18 005 393	18 756 066	19 144 405	19 229 222	20 096 015	20 651 822	20 959 108	21 549 780	22 300 151	22 650 627	24 917 359	18 756 066	20 096 015	21 549 780	24 917 359	24 917 359
2003	14 470 798	14 527 980	14 976 602	14 754 441	14 752 332	15 359 751	15 706 435	16 019 647	16 386 230	16 621 238	16 608 301	17 323 643	14 976 602	15 359 751	16 386 230	17 323 643	17 323 643
Total liabilities , end of the period, BGN thousand																	
2005	21 775 872	22 285 847															
2004	15 198 323	15 634 800	16 340 560	16 727 099	16 843 176	17 660 577	18 158 670	18 410 401	18 959 571	19 673 263	19 947 650	22 185 115	16 340 560	17 660 577	18 959 571	22 185 115	22 185 115
2003	12 413 277	12 474 347	12 882 639	12 702 089	12 694 628	13 252 494	13 584 220	13 870 342	14 218 293	14 410 754	14 364 457	15 042 658	12 882 639	13 252 494	14 218 293	15 042 658	15 042 658
Interest revenues, BGN thousand																	
2005	138 909	274 979															
2004	96 863	194 892	299 962	406 956	519 732	637 944	755 537	877 578	1 000 921	1 128 028	1 258 998	1 391 229	299 962	637 944	1 000 921	1 391 229	1 391 229
2003	74 730	145 393	223 314	302 382	385 403	465 864	550 315	636 814	724 416	816 202	908 081	1 012 487	223 314	465 864	724 416	1 012 487	1 012 487
Current profit/loss, BGN thousand																	
2005	61 908	85 653															
2004	41 497	78 677	114 157	132 792	169 150	224 081	257 720	300 494	335 347	366 104	420 992	434 112	114 157	224 081	335 347	434 112	434 112
2003	98 482	122 770	125 420	148 232	180 278	218 487	242 268	266 588	293 663	322 514	355 375	379 817	125 420	218 487	293 663	379 817	379 817
Social policy and industrial relations																	
Wage&Salary [3)]																	
Average Monthly Wage&Salary of employees under labor contract, total, nominal, BGN																	
2004	277	277	290	287	295	289	295	291	303	296	303	320	281	290	296	306	294
2003	264	259	274	272	280	274	276	273	286	276	286	302	266	275	278	288	277
Average Monthly Wage&Salary of employees under labor contract, public sector, nominal, BGN																	
2004	327	321	350	335	361	343	351	349	375	354	366	400	333	346	358	373	353
2003	308	299	325	318	340	327	326	324	352	326	344	368	311	328	334	346	330
Average Monthly Wage&Salary of employees under labor contract, private sector, nominal, BGN																	
2004	249	251	256	260	257	258	265	261	265	265	269	278	252	258	264	271	261
2003	238	234	242	244	242	241	244	242	245	245	249	260	238	242	244	251	244

(Continued)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3	Q4	Year
Real Average Monthly Wage&Salary of employees under labor contract, total, growth, corresponding period of the previous year =100, %																	
2004	-1.4	0.3	-0.3	-0.6	-1.4	-1.7	-0.7	0.2	-0.4	1.4	1.4	1.9	-0.5	-1.2	-0.3	1.6	-0.1
2003	5.9	5.0	6.8	7.2	5.8	5.3	4.4	2.2	4.1	1.5	3.5	4.7	5.9	6.1	3.6	3.3	4.7
Real Average Monthly Wage&Salary of employees under labor contract, public sector, growth, corresponding period of the previous year =100, %																	
2004	-0.2	0.7	1.4	-0.8	-0.6	-2.2	0.0	1.3	0.2	2.7	1.8	4.5	0.6	-1.2	0.5	3.0	0.8
2003	7.3	4.7	7.1	6.4	5.1	3.8	3.4	0.3	3.5	-1.7	2.6	4.9	6.4	5.1	2.5	2.0	4.0
Real Average Monthly Wage&Salary of employees under labor contract, private sector, growth, corresponding period of the previous year =100, %																	
2004	-1.7	0.6	-0.3	0.4	-0.6	-0.2	0.9	1.4	1.7	2.3	3.4	2.8	-0.5	-0.1	1.4	2.8	0.9
2003	6.8	6.6	7.7	9.1	6.7	7.2	4.9	3.9	4.1	3.5	3.5	4.3	7.0	7.7	4.3	3.8	5.7
Income and consumption of the households [3)]																	
Total income, monthly, average per person, nominal, BGN																	
2005	156.7	147.6															
2004	141.3	135.6	148.7	157.4	161.7	161.9	183.8	172.5	176.8	171.6	176.4	219.1	141.8	160.3	177.7	189.1	167.2
2003	128.8	122.4	135.8	142.4	146.6	152.3	157.2	157.0	157.0	156.2	162.1	210.6	129.0	147.1	157.0	176.3	152.4
Cash income, monthly, average per person, nominal, BGN																	
2005	152.2	144.5															
2004	136.4	131.9	143.0	145.0	147.3	150.5	154.5	156.6	160.8	158.3	157.2	189.9	137.1	147.6	157.3	168.5	152.6
2003	124.5	118.3	130.2	132.5	134.2	139.1	142.2	142.0	142.2	140.7	137.2	175.3	124.3	135.3	142.1	151.0	138.2
Total expenditure, monthly, average per person, nominal, BGN																	
2005	144.4	138.7															
2004	140.5	131.6	142.0	156.4	160.0	151.6	176.2	169.5	177.7	169.0	170.2	204.0	138.1	156.0	174.5	181.1	162.4
2003	125.2	116.0	130.1	135.5	143.2	141.9	147.1	151.1	153.1	154.9	153.4	197.9	123.8	140.2	150.4	168.7	145.8
Cash expenditure, monthly, average per person, nominal, BGN																	
2005	140.3	135.9															
2004	136.3	128.4	136.9	146.8	148.0	140.7	163.2	155.7	164.3	156.2	153.3	175.7	133.9	145.1	161.0	161.8	150.5
2003	121.1	112.3	124.9	126.0	131.4	129.7	133.2	137.0	139.3	140.4	135.0	163.6	119.4	129.0	136.5	146.3	132.8
Real total income, monthly, average per person, growth, corresponding period of the previous year =100, %																	
2005	7.4	4.8															
2004	3.1	3.9	3.1	4.2	3.3	-0.9	8.6	3.4	5.9	3.8	4.1	0.1	3.3	2.1	6.0	2.4	3.4
2003	11.6	7.9	7.5	8.7	5.5	11.1	12.2	6.3	2.0	3.0	7.0	2.0	8.9	8.5	6.7	3.9	6.9

(Continued and end)

	I	II	III	IV	V	VI	VII	VIII	IX	X	XI	XII	Q1	Q2	Q3	Q4	Year
Real cash income, monthly, average per person, growth, corresponding period of the previous year =100, %																	
2005	8.0	5.4															
2004	3.0	4.6	3.5	3.1	2.7	0.9	0.9	3.7	6.4	6.4	9.6	4.2	3.7	2.2	3.7	6.5	4.0
2003	11.9	7.7	7.8	8.3	7.1	11.3	11.7	6.6	1.3	2.9	3.4	5.7	9.1	8.9	6.4	4.2	7.1
Real total expenditure, monthly, average per person, growth, corresponding period of the previous year =100, %																	
2005	-0.6	1.4															
2004	5.5	6.4	2.8	8.8	4.6	-0.4	11.3	5.5	9.2	3.2	6.2	-0.9	4.8	4.3	8.6	2.5	5.0
2003	12.4	3.3	8.3	8.9	3.1	7.3	7.9	3.7	0.1	4.3	3.1	1.9	8.0	6.4	3.8	3.1	5.2
Real cash expenditure, monthly, average per person, growth, corresponding period of the previous year =100, %																	
2005	-0.4	1.9															
2004	5.8	7.2	3.3	9.8	5.4	1.1	13.9	6.9	10.9	5.2	8.7	3.3	5.4	5.4	10.5	5.6	6.7
2003	12.8	3.1	8.9	8.6	4.8	7.7	7.7	4.3	-0.4	4.6	3.4	5.9	8.2	7.0	3.7	4.7	5.9

1) Excluding credits to Monetary Financial Institutions.

2) Including credits to Non-financial Public Corporations.

3) Average monthly values by quarter are calculated as simple average of monthly per capita values.

Sources: Employment Agency, Bulgarian National Bank, Ministry of Finance, National Statistical Institute and own calculations.

Acronyms:

GDP = Gross domestic product

" - " = Not applicable or missing data

ANNEX 2: REGULATORY DOCUMENTS PROMULGATED JANUARY 1 – MARCH 31, 2005

Regulatory Documents	**Status**	**Official Gazette**
GOVERNMENTAL REGULATION on closing the State Agency for Energy and Energy Resources and on approving Rules on the Structure of the Ministry of Energy and Energy Resources	Amended/ Supplemented	No. 1/4.01.2005
GOVERNMENTAL REGULATION on the transformation of the State Energy Efficiency Agency within the Council of Ministers into Energy Efficiency Agency at the Minister of Energy and Energy Resources and on the approval of Rules on the Structure of the Energy Efficiency Agency	Amended/ Supplemented	No. 1/4.01.2005
GOVERNMENTAL REGULATION on the approval of Rules on the Structure of the Energy Efficiency Agency	New	No. 1/4.01.2005
RULES ON THE STRUCTURE of the Energy Efficiency Agency	Amended/ Supplemented	No. 1/4.01.2005
REGULATION on the reduced working hours	Amended/ Supplemented	No. 1/4.01.2005
REGULATION on the terms and procedure of registration and removal from the register; on the data subject to registration; on the procedure of keeping the registers; on the content and form of the crop and stock declarations, and on the control of registered persons and their activities	Amended/ Supplemented	No. 1/4.01.2005
REGULATION on the requirements for tobacco products labeling, marking, and outer appearance; and on specifying standards for compliances assessment of the content of harmful ingredients in cigarettes	Amended/ Supplemented	No. 2/7.01.2005
REGULATION on the terms and procedures of registering the prices of locally produced and imported tobacco products, on the trade in tobacco products, and on trade control	Amended/ Supplemented	No. 2/7.01.2005
GOVERNMENTAL REGULATION on structural changes in the health care system	New	No. 3/11.01.2005
RULES ON THE STRUCTURE of the Customs Agency	Amended/ Supplemented	No. 3/11.01.2005
REGULATION on the terms and procedures of informing workers and employees and on the allocation and payment of the guaranteed claims in the event of employer's bankruptcy	New	No. 3/11.01.2005
REGULATION on the management, monitoring, assessment, control of the efficiency of implementation, and the information support of regional development plans	New	No. 3/11.01.2005
REGULATION on the specification of a positive list of medicines in the Republic of Bulgaria	Amended/ Supplemented	No. 4/12.01.2005
REGULATION on the foreign exchange positions of banks	Amended/ Supplemented	No. 5/14.01.2005
REGULATION on heat and energy conservation in buildings	New	No. 5/14.01.2005
REGULATION on the substantial exposures of banks	Amended/ Supplemented	No. 5/14.01.2005
REGULATION on the capital adequacy of banks	New	No. 5/14.01.2005
REGULATION on the conditions and procedures of registration of persons implementing certification of buildings and energy efficiency inspections, and on receiving information	New	No. 5/14.01.2005
REGULATION on the minimum requirements for securing the health and safety of workers in the event of potential risk of explosive atmosphere	New	No. 6/18.01.2005
REGULATION on securing health and safety in work with automobiles	New	No. 6/18.01.2005
REGULATION on specifying basic prices, excluded area prices, and on creating right of use and servitude on forests and forestry fund lands	Amended/ Supplemented	No. 6/18.01.2005
REGULATION on the procedures and methods of calculating the coefficient referred to in Article 10, paragraph 4 of the Export Insurance Act and on specifying the mechanism of allocation of funds from the central budget and payment of insurance indemnity	New	No. 6/18.01.2005
GOVERNMENTAL REGULATION on the approval of Rules on the Structure of the Ministry of Agriculture and Forestry and on the transformation and closing of administrative structures at the Minister of Agriculture and Forestry	Amended/ Supplemented	No. 8/21.01.2005
RULES on the implementation of the Excise Duty Act	Amended/ Supplemented	No. 8/21.01.2005
RULES ON THE STRUCTURE of the Ministry of Agriculture and Forestry	Amended/ Supplemented	No. 8/21.01.2005
RULES ON THE STRUCTURE of the National Forestry Administration	Amended/ Supplemented	No. 8/21.01.2005
REGULATION on the capital adequacy and liquidity of investment brokers	Amended/ Supplemented	No. 8/21.01.2005

REGULATION on the terms and procedures of assigning and implementing the forest and national forestry fund reproduction activities	New	No. 8/21.01.2005
REGULATION on the procedures of declaring goods in writing before customs offices	Amended/ Supplemented	No. 8/21.01.2005
GOVERNMENTAL REGULATION on the foreign trade regime of the Republic of Bulgaria	Amended/ Supplemented	No. 9/25.01.2005
NSSI INSTRUCTION on the collection of data regarding the insured persons from insurers and from self-insuring persons	Amended/ Supplemented	No. 9/25.01.2005
TARIFF of the charges collectable pursuant to the Tourism Act	Amended/ Supplemented	No. 9/25.01.2005
ACT on the Bulgarian National Bank	Amended/ Supplemented	No. 10/28.01.2005
DECREE on return of the Act on the Regulation of Water Supply and Sewerage Service to the National Assembly for reconsideration		No. 10/28.01.2005
GOVERNMENTAL REGULATION on the implementation of the 2005 State Budget of the Republic of Bulgaria	New	No. 10/28.01.2005
GOVERNMENTAL REGULATION on specifying new minimum wage amount for Bulgaria	New	No. 10/28.01.2005
GOVERNMENTAL REGULATION on specifying first and second level spending units for appropriations	Amended/ Supplemented	No. 10/28.01.2005
RULE on the implementation of the Concessions Act	Amended/ Supplemented	No. 10/28.01.2005
ACT on the marine spaces, inland waterways, and ports of the Republic of Bulgaria	Amended/ Supplemented	No. 11/1.02.2005
ACT on Foreigners in the Republic of Bulgaria	Amended/ Supplemented	No. 11/1.02.2005
ORDINANCE on rules and structural standards for the different types of territories and structural zones	Amended/ Supplemented	No. 11/1.02.2005
ORDINANCE on the registration and reporting of sales in commercial outlets	Amended/ Supplemented	No. 12/4.02.2005
ORDER on the approval of Chart of Accounts of Public Enterprises (CAPE)	New	No. 12/4.02.2005
GOVERNMENTAL REGULATION on approval of Tariff of Charges Collectable by the Public Health Control Authorities Pursuant to the Health Act	New	No. 13/8.02.2005
GOVERNMENTAL REGULATION on allocation of funds from the 2005 central budget to the Ministry of Economy budget for implementation of measure of the Innovation Strategy of the Republic of Bulgaria – Set up of National Innovation Fund	New	No. 13/8.02.2005
GOVERNMENTAL REGULATION on approval of Rules on the Structure of the Ministry of Labor and Social Policy	Amended/ Supplemented	No. 13/8.02.2005
TARIFF of charges collectable by the public health control authorities pursuant to the Health Act	New	No. 13/8.02.2005
ACT on the support of agricultural producers	Amended/ Supplemented	No. 14/11.02.2005
ORDINANCE on the keeping of registers by the Financial Supervision Commission and on the registrable facts	Amended/ Supplemented	No. 15/15.02.2005
ORDINANCE on the form and content of the annual financial statements of insurers and health insurance companies	New	No. 15/15.02.2005
ORDINANCE on the use charges for public airports and for aeronavigation services in the Republic of Bulgaria	Amended/ Supplemented	No. 15/15.02.2005
RULES on the structure and operation of regional development councils	New	No. 16/18.02.2005
ORDER on approval of a list of municipalities in which in the last year the unemployment level is 50 per cent above the average national level for the period concerned	New	No. 16/18.02.2005
ORDER on the special treatment regarding the preservation and use of medicinal plants in 2005	New	No. 16/18.02.2005
NATIONAL FRAMEWORK AGREEMENT 2005 between the National Health Insurance Fund on one part and the Bulgarian Doctor's Union and the Union of Dentists in Bulgaria on the other part	Amended/ Supplemented	No. 17/22.02.2005
ACT on the regulation of water supply and sewerage services	New	No. 18/25.02.2005
Energy ACT	Amended/ Supplemented	No. 18/25.02.2005

Water ACT	Amended/ Supplemented	No. 18/25.02.2005
CONSTITUTION of the Republic of Bulgaria	Amended/ Supplemented	No. 18/25.02.2005
ORDINANCE on the terms and procedures of allocating grants for investments in farms from Community's Special Accession Program for Agriculture and Rural Development (SAPARD) for Bulgaria	Amended/ Supplemented	No. 18/25.02.2005
TAX PROCEDURE CODE	Amended/ Supplemented	No. 19/1.03.2005
Labor CODE	Amended/ Supplemented	No. 19/1.03.2005
Administration ACT	Amended/ Supplemented	No. 19/1.03.2005
Banks ACT	Amended/ Supplemented	No. 19/1.03.2005
Telecommunications ACT	Amended/ Supplemented	No. 19/1.03.2005
Public Servant ACT	Amended/ Supplemented	No. 19/1.03.2005
ACT on Local Self-Government and Local Administration	Amended/ Supplemented	No. 19/1.03.2005
ACT on Notaries and Notary Activity	Amended/ Supplemented	No. 19/1.03.2005
ACT on the expropriation of property acquired as a result of criminal activity	New	No. 19/1.03.2005
Postal Service ACT	Amended/ Supplemented	No. 19/1.03.2005
ACT on the public offering of securities	Amended/ Supplemented	No. 19/1.03.2005
Crisis Management ACT	New	No. 19/1.03.2005
DECISION of the National Assembly on amendments to the structure of the Council of Ministers of Republic of Bulgaria	New	No. 19/1.03.2005
DECISION of the National Assembly on the structure of the Council of Ministers of Republic of Bulgaria	New	No. 19/1.03.2005
RULES on the operation of the National Assessment and Accreditation Agency	New	No. 19/1.03.2005
RULES ON THE STRUCTURE of the Registrations Agency	Amended/ Supplemented	No. 19/1.03.2005
ORDINANCE on the terms and procedures of recognizing agricultural producers' organizations	Amended/ Supplemented	No. 19/1.03.2005
ORDINANCE on the terms and procedures of allocating grants for development and improvement of the interurban infrastructure from Community's Special Accession Program for Agriculture and Rural Development (SAPARD) for Bulgaria	Amended/ Supplemented	No. 19/1.03.2005
ORDINANCE on the terms and procedure of allocating grants for producers' markets and commodity markets for fruit, vegetables, flowers, and fish from Community's Special Accession Program for Agriculture and Rural Development (SAPARD) for Bulgaria	Amended/ Supplemented	No. 19/1.03.2005
ORDINANCE on the terms and procedures of allocating grants for forestry, reforestation of agricultural land, investments in forest areas, and processing and marketing of forest products from Community's Special Accession Program for Agriculture and Rural Development (SAPARD) for Bulgaria	Amended/ Supplemented	No. 19/1.03.2005
ORDINANCE on the trust councils of the supplementary compulsory pension insurance funds and on the consultative councils of the supplementary voluntary pension insurance funds	New	No. 19/1.03.2005
RULES on the structure and operation of the Guarantee Fund	New	No. 20/8.03.2005
ORDINANCE on the creation and maintenance of a register of agricultural producers	Amended/ Supplemented	No. 20/8.03.2005
ORDINANCE on the minimum reserve requirements of banks in BNB	Amended/ Supplemented	No. 20/8.03.2005
DECISION of the National Assembly on approval of a National Strategy and Action Plan for introduction of information and communication technologies in Bulgarian schools	New	No. 20/8.03.2005

DECISION of the National Assembly on approval of a National Strategy and Action Plan for introduction of information and communication technologies in Bulgarian schools	Amended/ Supplemented	No. 21/11.03.2005
RULES ON THE STRUCTURE of regional administrations	Amended/ Supplemented	No. 22/15.03.2005
ORDINANCE on the terms and procedures of receiving applications, completing dossiers, and keeping a register of dossiers of foods of tradition-specific nature	New	No. 23/18.03.2005
ORDINANCE on the conditions to be satisfied by quality wine with designation of origin and on the terms and procedures of their approval	Amended/ Supplemented	No. 23/18.03.2005
PENAL CODE	Amended/ Supplemented	No. 24/22.03.2005
GOVERNMENTAL REGULATION on the terms and procedures of granting provisional interest-free credits from the central budget to municipalities for cost financing of approved projects under Community's Special Accession Program for Agriculture and Rural Development (SAPARD) for Bulgaria and of repayment of such credits	New	No. 24/22.03.2005
ORDINANCE on pensions and on the length of service for social security purposes	Amended/ Supplemented	No. 24/22.03.2005
ORDINANCE on working hours, rests, and leaves	Amended/ Supplemented	No. 24/22.03.2005.
TARIFF of charges collectable by the Communications Regulation Commission pursuant to the Postal Services Act and the Electronic Document and Electronic Signature Act	Amended/ Supplemented	No. 24/22.03.2005
NATIONAL PROGRAM for statistical investigations in 2005	New	No. 25/23.03.2005
RULES on the implementation of the Employment Promotion Act	Amended/ Supplemented	No. 26/25.03.2005
ORDINANCE on the procedure of issuing permits to producers and procurers of seeds and propagating material and of registering traders in seeds and propagating material	Amended/ Supplemented	No. 26/25.03.2005
Labor CODE	Amended/ Supplemented	No. 27/29.03.2005
ACT on genetically modified organisms	New	No. 27/29.03.2005.
Anti-family violence ACT	New	No. 27/29.03.2005.
Employment Promotion ACT	Amended/ Supplemented	No. 27/29.03.2005
Seeds and Propagating Material ACT	Amended/ Supplemented	No. 27/29.03.2005
GOVERNMENTAL REGULATION on the allocation of funds from the 2005 central budget to the Council of Ministers budget for the construction of small projects of regional importance	New	No. 27/29.03.2005.
GOVERNMENTAL REGULATION on the set up of a Consultative Council on Foreign Investments and Finance	Amended/ Supplemented	No. 27/29.03.2005
RULES on the implementation of the Act on control of foreign trade in arms and in goods and technologies of possible dual use	Amended/ Supplemented	No. 27/29.03.2005
ORDINANCE on the connection of electricity producers and consumers to the electricity transfer network and the electricity distribution networks	New	No. 27/29.03.2005
ORDINANCE on building up the wages fund of commercial companies with more than 50 per cent state or municipal interest in their capital in 2005	New	No. 27/29.03.2005.
ORDINANCE on the conditions to be satisfied by government loan financed investment projects and projects applying for government guarantee finance, and on the procedure of consideration of such projects	Amended/ Supplemented	No. 27/29.03.2005

METHODOLOGICAL NOTES

The review of the Bulgarian economy is an original, expert product of the Center for Economic Development, made possible owing mostly to the long experience of the Center in the field of applied studies of economic policy and economic development of the country.

A. GENERAL NOTES

Structure of the report. The present report on the Bulgarian economy comprises: (1) a summary of the report, (2) economic analysis in 14 sectors described in detail in *Topics and Sections*, (3) two annexes containing updated macroeconomic indicators and the regulatory documents promulgated in the review period, (4) these methodological notes, (5) English translation of the summary, and (6) chronicle of CED's activity in the review period.

Review period. The report contains detailed presentation and assessment of the first quarter of 2005. Where necessary, significant events, facts, and data of periods before 2005 have been highlighted. Where possible, data comparisons have been made against previous years. At many points, the short-term trend has also been outlined.

Selection of Topics. The structure of the presentation above follows simultaneously two principles. First, we strive for providing a more comprehensive presentation of the subject matter areas, with corresponding prioritization of the range of matters discussed. Second, the different topics and analyses reflect the experience and interests of the experts from the Center for Economic Development.

Topics and Sections. The review of the Bulgarian economy starts with presentation of the macroeconomic dynamics discussed against the background of the following basic categories: GDP, foreign trade, foreign direct investments, inflation, employment, and unemployment. After that, the annual values of the Estat index of business climate in Bulgaria are presented and compared. The national economic events in the review period, which have direct or indirect effect on the competitiveness of the Bulgarian enterprises, are analyzed in the section on the enterprise policy. Such events are described in the sub-sections on encouragement of entrepreneurship, investment incentive policy, access to finance, effectively functioning markets, commercial policy and preparation for the single European market, privatization and concessioning, regulatory regimes, pubic procurement regulation, public administration reform, combating corruption, and index of economic freedom. In the specific Bulgarian economic environment, the enterprise policy has two basic aspects: (1) transformation, which is mostly associated with the process of privatization and liberalization of the economy, and (2) competitiveness, which involves the policies to achieve economic growth and competitiveness of the Bulgarian enterprises. The corresponding section of the report studies problems concerning both aspects of Bulgarian enterprise policy.

The *public finance* section covers budget implementation and fiscal reserve dynamics, as well as foreign and domestic debt. The broad topic of *social and healthcare policy* encompasses the issues of social security, employment and unemployment, labor market policy, incomes, and social partnership. Current problems and the state of the healthcare reform is reviewed. *Environmental policy* is discussed both as a specific element of economic policy and as a factor for the economic environment.

The financial sector covers the *banking system* and the *capital market*. Then comes a review of a number of sectors of significant importance to the economic development of Bulgaria – *energy, transport, high technologies and communications, tourism, and agriculture*. The section on *regional policy* studies the political decisions, facts and events related to the achievement of balanced and sustainable regional development and a reduction of regional disparities, as well as the process of social and economic cohesion with the European Union.

The annexes at the end constitute an integral part of the presentation. *Annex 1* presents in detail the basic macroeconomic indicators. *Annex 2* contains the list of newly passed legislation and amendments to laws, which are of significant importance to the economic development of the country and have been promulgated in the Official Gazette in the first quarter of 2005. As of 2005 this annex also contains a brief review of the more important legislative amendments in the respective quarter.

The work was finally completed on: 15 April 2005.

B. DATA SOURCES

Basic Sources. Analyses are based on statistical and other information and data from the sources:

- National Assembly
- Council of Ministers
- Ministry of Energy and Energy Resources
- Ministry of Agriculture and Forestry
- Ministry of Economy
- Ministry of Transport and Communications
- Ministry of Labor and Social Policy
- Ministry of Finance
- National Statistical Institute
- National Social Security Institute
- Employment Agency
- Agency for Small and Medium-sized Enterprises
- Privatization Agency
- Bulgarian National Bank
- Bulgarian Stock Exchange – Sofia AD
- Financial Supervision Commission
- Delegation of the European Commission

- European Union
- Eurostat
- European Bank for Reconstruction and Development
- Organization for Economic Cooperation and Development
- World Bank
- Official Gazette
- The periodical press

Additional Sources. We have also used analyses from a large number of our own research and publications, some of which are elements of assigned research projects, as well as analyses by other researchers. The particular sources and publications are quoted at their respective places in the text.

C. THE ESTAT INDEX OF BUSINESS CLIMATE IN BULGARIA

The business climate survey is based on the original methodology, developed by the team of the Agency for Social and Marketing Surveys Estat and the Center for Economic Development. Below we describe some of the more significant details.

Sampling Methodology. The survey is conducted on a quarterly basis among the managers of some 400 companies. The sample is a two-level panel (at the first level the companies are divided into groups by regions, and at the second level – according to their economic sectors as per nomenclature A6 of the NSI), and it is grouped on the basis of the indices “number of employees” and “type of ownership”. The sample guarantees representativeness at the business level.

Registration Methodology. Information is collected using the work place inquiry method. The interviews were held with the owners of the companies covered by the sample or with people authorized to make managerial decisions and to sign financial statements (managers, chief accountants, commercial or marketing directors).

Questionnaire Contents. The questionnaire contains eight substantive questions and three passport questions. The integrated index is comprised of three components. Questions one to five comprise Component I – “General Condition of the Company”; question six – Component II – “Investment Attitudes and Corporate Strategies”; questions seven and eight – Component III – “Business Environment”.

Index Calculation: (1) preliminary preparation. The preliminary preparation includes data weighting according to the indicators “economic sector” and “number of employees”, and recoding and calculating values for the respective questions.

- Questions with one possible answer – the original scales are of Likert type with codes from 1 (the highest degree) to 5 (the lowest degree). Recoding is done so as to have a scale from -2 (the lowest degree) to +2 (the highest degree).
- Multiple-choice questions – these questions are recoded in advance so that possible answers are located symmetrically on both sides of the neutral point (the zero).

Index Calculation: (2) component indices. The index for each component, which includes an indicator question, is calculated as a weighted average value. Weights are assigned to each indicator within a component by means of expert evaluation. The value for each component index (“General Condition of the Company”; “Investment Attitudes and Corporate Strategies”; “Business Environment”) is calculated as a weighted average.

Index Calculation: (3) integrated index. The integrated index is calculated as a weighted average of the three component indices. The weight for each of the component indices is determined by means of expert evaluation.

Index Values. The Estat index of business climate assumes values from -100 to +100. The business climate condition is assessed according to the following scale, similar to the one used in the German IFO Business Climate Index:

-100	to -61	very poor
-60	to -21	poor
-20	to +20	average
+21	to +60	good
+61	to +100	very good

Index Interpretation. All components (without exception), as well as the integrated index, assume values in the [-100, +100] range. This set of tools allows determining also the direction of the index. The difference between the values of questions Q3 (assessment of future conditions), Q2 (assessment of current conditions) and Q1 (assessment of prior conditions) is applied as a criterion for determining the direction.

Additional Notes. Besides everything aforesaid about the methodology, in many places throughout the text additional methodological and other notes and comments are provided.

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EVENTS

New Appointment

Mr. Ivaylo Nikolov, Program Director, CED, has been awarded a full scholarship for a Doctoral degree in economics at the University of Loughborough, Great Britain. He has completed research and has contributed in co-publications with professors from the university, which is in the top ten of England's higher education schools.

Since 1 April, 2005, the position of Program Director in CED is held by Mr. Krassimir Petrov, a holder of Ph.D. degree in Economics from the Ohio State University. In 1994 Dr. Petrov earned his Master's degree in economics at a joint University of Delaware–BAS program. He then lectured in UNWE and in the Department of Economics at Sofia University. In 1995 Mr. Petrov completed his Master's degree in European Integration at the University of Limerick, Ireland, and continued his study for a Doctoral degree in the USA. He completed his Doctoral degree in 1999 and joined SBC Communications, where he worked till 2004.

Presentation of the Project: Involving Small and Medium-sized Business for an Active Counteraction to Corruption

CED is implementing an 18 month project: 'Involving Small and Medium-sized Business for Active Counteraction to Corruption' (December 2004 – May 2006). The project is carried out with financial support from the European Union within PHARE's Civil Society Development 2002 Program. CED partners include the National Association of Small and Medium Business and the National Business Development Network.

Blenika Djelepova, CED expert, and Stanislav Slavov, Project Coordinator, at the meeting with media in Turgovishte, 13 January 2005.

The project will be implemented in the following municipalities: Vidin, Montana, Rousse, Teteven, Turgovishte, Silistra, Bourgas, Sliven, Haskovo, Pazardjik, Gotse Delchev, and Blagoevgrad.

The main goal of the project is to involve actively representatives of the small and medium business in partnership with non-governmental organizations, industrial associations, governmental and municipal authorities for joint actions, focused at curbing corruption practices, creating intolerance to corruption at municipal and governmental levels and encouraging of civic participation in these processes.

In January and February 2005 the CED expert team presented to the municipal and regional administrations, business organizations, judicial system, and media the project goals and activities. Further project steps have been developed in cooperation with local partners – organizing focus-groups and conducting nationally representative sociological survey targeting identification of typical corruption practices and resulting problems for the Bulgarian small and medium-sized business.

At the anti-corruption seminars the CED team and its project partners will present to the business representatives the anti-corruption legislation and experience of EU Member States, the opportunities for amendments to the Bulgarian legislation and for business environment regulation.

Representatives of big BIBA member companies will share their experience and good practices in developing relations based on business ethics. Representatives of the small and medium-sized business will join hands in developing codes of business ethics. Indicative codes of business ethics will be developed for three branch organizations.
The project targets setting up of business ethics societies in two municipalities – Vidin and Haskovo. Members of these informal associations will be owners or managers of companies which have approved their own codes of business ethics. They will exercise civil control over the administration and will also see to the correct behavior of their members.

Use of Public Sector Information in Europe

The European Public Sector Information Network ePSINet (www.epsigate.org) organized an international conference on the practice and perspectives of the commercial use of public sector information in Europe (the ePSINet Policy Conference).

It was held in Athens on 14 January 2005 and was attended by representatives of public sector information suppliers and users, international experts and representatives of the Commission's Directorate General of Information Society.

Mr. Prokopis Pavlopoulos, Greek Minister of Internal Affairs, Public Administration and Decentralization, delivered a welcoming speech. Major contributors included representatives of the European Commission, international federations and associations, companies, consulting and analytical centers. CED expert Mrs. Daniela Petrova participated in the conference.

Discussions at plenary sessions and expert group meetings were focused on: the economic value of public sector-generated information, the potential of Directive 2003/98/EU to encourage reuse of public sector information by the private sector on a market principle basis through development of new value-added digital content products and services. Assessment was made of Community legal and financing mechanisms for overcoming barriers to the commercial use of public sector information, including the eContent and eContent+ financing programs.

Working Group 19 on telecommunications and information technology within the Ministry of Transport and Communications coordinates the preparation for transposing Directive2003/98/EU, which should be completed by 2007.

Partners for Financial Stability Regional Meeting

'Partners for Financial Stability' is a co-initiative of USAID and the US Department of State, East-West Management Institute and other non-governmental organizations. Since its establishment in 1999 it has been operating in Central and Eastern Europe towards building up the "missing links" in the financial systems of these countries. The program operates in the following areas: accounting and audit, banking, capital markets, insurance and pension system reforms, counteracting money laundering. Since 2004 the program has been striving to expand its activity in South Eastern Europe, seeking opportunities for co-actions with partner organizations which have cooperated with the program in certain fields. CED cooperated with the program in implementing the project: Economic Effect of the Operation of the Bulgarian Special Pledges System in 2002.

The objective of the regional meeting organized in Sofia on 22 and 23 February 2005 was to discuss regional approaches towards developing of a more competitive, dynamic and solid financial sector in South Eastern Europe. At the Partners for Financial Stability meeting CED's expert Mr. Petar Stankov made a presentation on SME Finance in Bulgaria and SEE. A focal point of the presentation was the opinion of the small and medium-sized business in Bulgaria and the region on the development of access to available finance.

For more information on the meeting and Petar Stankov's presentation, please visit:
http://www.pfsprogram.org/activities_pfs_see_bulgaria.php

Fiscal Decentralization in Bulgaria: Increasing Autonomy of Local Governments

On 8 March 2005 CED organized an international conference on fiscal decentralization. Invited were representatives of: Parliament, Presidency, public administration, local authorities, non-government organizations, academic circles, donor organizations, embassies, media and many independent experts. Conference participants included: Mrs. Nina Radeva, Chairperson of the parliamentary Budget and Finance Commission, Mr. Lubomir Datsov, Deputy-minister of Finance, Mr. Ivaylo Kalfin, Advisor to the President, Mrs. Ginka Chavdarova, NAMRB's Executive Director, Mrs. Ginka Kapitanova, FLGR's Executive Director, Mr. Javor Stoyanov, Director, MRDPW.

The conference was organized within the project: 'Fiscal Decentralization in Bulgaria: Next Steps – Increasing Autonomy of Local Governments', financially supported by Local

Left to right: Dilyan Enkin, Management Board member, NAMRB, Mayor of Troyan; Nina Radeva, Chairperson of the parliamentary Budget and Finance Commission; Alexander Boshkov, Co-chair of CED Board of Trustees; Adrian Ionescu, Director, Local Government Initiative/Open Society Institute, Budapest; Monica Toba, Program Coordinator, Public Policy Institute, Bucharest

Government Initiative/Open Society Institute (LGI/OSI), Budapest. It is a follow up of the conference on 'Fiscal Decentralization in Bulgaria – Focusing the Debate' organized at the end of 2002, which drew a picture of the fundamental problems and future developments of the process. It was followed by a discussion among outstanding legislature, central and local government, NGO sector and academic circles representatives, which highlighted decentralization process priorities. Drawing on achieved results and conclusions, CED now steers experts' interest and public debate into some more practical decentralization aspects: optimizing the revenue part of municipal budgets; measures to improve expenditure efficiency; vertical and horizontal aspects of fiscal decentralization.

To guarantee the practical orientation of analyses and recommendations, these are underpinned by results of a focus-group sociological survey involving local government, public administration and local community representatives in six Bulgarian municipalities: Veliko Turnovo, Nova Zagora, Montana, Plovdiv, Razlog, and Russe. The objective is to highlight problems typical for "big" and "small" municipalities. Survey results and analyses are summarized in a final report with conclusions and recommendations. The objective of the conference with participation of local and foreign experts, representatives of central and local authorities and partner organizations (National Association of Municipalities in the Republic of Bulgaria and Ministry of Regional Development and Public Works) is to find the crossing point of different interests, to establish a balance of central and local government views, to provide tailored solutions in aid of government authorities on the basis of accumulated knowledge, experience and analytical potential of a number of non-government and academic organizations.

Round Table on Education

On 17 March 2005 Mr. Alexander Boshkov, Co-chair of CED Board of Trustees, and Miss Magdalena Varshilova, CED expert, took part in a round table on: 'Buns and Quality ……… WHAT EDUCATION ARE WE INVESTING IN?' organized by Open Society Institute.

The objective of the discussion was to find the answer to the question: What are the areas in which non-partisan consensus on Bulgarian education development could be achieved? The guests of the forum, which included representatives of political parties, non-governmental organizations, school authorities, the general public, syndicates and employers, presented their views on the five strategic priorities of Bulgarian education in the next 5-10 years and on the immediate tasks and measures to be implemented within a year.

Bulgarian education is practically the only sphere where for a variety of reasons reforms have been scarcely implemented in the process of transition from a centrally-planned to an efficiently functioning market economy. The negative effect of delayed reforms, which is now noticeable by the whole society, as well as the need to create a flexible labor market with more and better jobs, with a view to the forthcoming accession of Bulgaria to the EU, require urgent measures from the Bulgarian Government towards adequately reforming the Bulgarian education system.

Seminar on Financing Entrepreneurship

A Seminar on Financing Entrepreneurship at Regional and Local Level in Bulgaria and other SEE Countries was organized on 17 March 2005 in Sofia, launching the new Bulgaria Enterprise Policy Assessment 2004 report. CED drafted the report for OECD for a second consecutive year.

The research was conducted in March and April in cooperation with Agency Estat and included 50 Bulgarian entrepreneurs in 6 focus group discussions organized in 5 Bulgarian towns. The main goal of the research was to gain entrepreneurial assessment on how the economic policy was developing in several policy dimensions: (1) institutional framework for SME development; (2) administrative and regulatory environment; (3) tax policy for small businesses; (4) financial instruments for new and small enterprises; (5) business consultancy services; (6) business incubators; and (7) entrepreneurship, training, and access to technology.

The goal of the project was not only to attain business feedback on these policy dimensions, but also to formulate a number of policy measures to be implemented for achievement of a better business environment for SMEs in Bulgaria. Their role and potential for the economy still request a better understanding and faster implementing of measures by the policy makers in the country.

At the end of 2004 CED presented the first version of the report on Bulgaria. The final version to be developed by OECD will be available free at www.ced.bg and www.investmentcompact.org

Mr. George Prohaski, Co-chair of CED, and Petar Stankov, CED expert and 2004 Project Coordinator for Bulgaria took part in the seminar. For further information and downloading of the Bulgaria Enterprise Policy Assessment 2004 report, please visit:
http://www.ced.bg/publication.php?PublicationID=106

Discussion Forum on Social Security Burden

On 23 March 2005 CED experts Ms. Magdalena Varshilova and Mr. Nikolay Ivanchev took active part in the discussion forum on: 'Higher Social Justice of Total Tax and Social Security Burden Distribution', organized by CITUB with financial support from Friedrich Ebert Foundation.

Focus of discussion was the new CITUB-developed mechanism for higher social justice of total tax and social security burden distribution and more efficient anti-poverty measures, which invoked contradictory responses from invited guests – representatives of syndicate and employer's organizations, non-governmental organizations, political forces and the civil society. The new solutions proposed by CITUB include on the whole differentiated rates of compulsory personal social security contributions and overcoming of the current discriminating social security relationship with respect to persons employed under labor and office contracts.

The Center for Economic Development stands for the syndicates' idea for involving the State as a universal insurer along with the worker and the employer and for making public servants pay for their personal social security contributions. In our opinion, the solution of the problem with the long-term financial sustainability of the pension system should involve the reduction of the social security burden and the setup of a reserve fund financed by domestic and foreign sources.

MEETINGS "ON THE ROOF"

Meeting with Israeli Delegation

A meeting of CED management and team of experts with Israeli delegation was held on 11 February 2005 at the Roof Hall. CED guests were H.E. Mr. Avraham Sharon, Ambassador Extraordinary and Plenipotentiary of the State of Israel; Mrs. Talya Lador-Fresher, Director, Europe Department, Economic Affairs Division, Ministry of Foreign Affairs; Mrs. Dana Benvenisti-Gabay, Deputy Chief of Mission to Bulgaria.

The CED team presented a detailed analysis on the condition of the Bulgarian economy, which was followed by lengthy discussions on presented statistical indicators and topical economic development issues. Guests were particularly interested in the topic of competitiveness of the Bulgarian economy in the context of Bulgaria's accession to the European Union and in the opportunities for attracting foreign investments to Bulgaria.